



# NAVAL POSTGRADUATE SCHOOL

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## THESIS

**DEMOGRAPHICS: THE DOWNFALL OF SAUDI ARABIA**

by

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**DEMOGRAPHICS: THE DOWNFALL OF SAUDI ARABIA**

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## **ABSTRACT**

Threats to Saudi Arabia have historically been categorized as external, reference immediate neighbors, and internal via conservative Islamic opposition groups. The United States, because of its security arrangement, has guaranteed the sovereignty of Saudi Arabia. Opposition groups within the Kingdom, while attracting recent attention, are placated through concessions to the Ulema and direct payment. However, primary destabilization of the Saudi regime today is due to stress placed upon the Saudi economy and ruling structure by an unprecedented population growth within the Kingdom over the last two decades. The argument is that growth in the Kingdom has rapidly outstripped the regime's ability to provide for it, undermining a key pillar of the Royal Family's ruling legitimacy. This thesis explores stress placed upon the Saudi regime through its population growth. Due to effects of relative deprivation, the Saudi populace is demanding government participation, calling to question personal regime expenditures, and the motivations of regime foreign policy, especially in relation to the United States. This study will briefly address courses of action available to the Royal Family, current effects of population growth upon the Saudi economy, and the regional and international consequences of a failed Saudi government.

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# **I. INTRODUCTION**

## **A. INTRODUCTION**

The following study will focus on the development of the Saudi economy in the late 1960's and follow the trend of expansion and recession up to the present day. It will also make use of short and long-term predictions of oil production and export out to 2008 and into 2020. I expect to discover that western government officials downplay the extent to which demographic and economic stresses endanger the stability of the current regime in Saudi Arabia. Current assumptions are that Saudi Arabia has plenty of oil and whoever is in charge will need to sell it in order to survive.

Saudi Arabia commands over 25% of the world's proven oil supply, two thirds of the Middle Eastern supply, and enjoys solid economic ties with the world's highest developed countries. It enjoys an ease of oil production, export, and transportation that is globally unrivaled. Although countries outside of OPEC and the Middle East currently produce more oil, this is projected to shift dramatically over the next decade. The Persian Gulf alone is estimated to increase from its 2001 supply of 30% of world oil exports to 37.8% by 2025. The rest of the world, specifically developing Asia, will become even more dependent on the region.

This thesis will explore the hypothesis that the increasing population of Saudi Arabia will overcome the government's ability to provide for it. If unrest among the population should occur, the royal family may either react brutally or decide to share power by creating governmental institutions to allow for popular representation.

Although Crown Prince Abdullah has liberalized foreign investment laws, allowed discussions of a proposed taxation system to take place, and increased privatization, it remains to be seen whether or not these reforms are aggressive enough or will continue with any consistency to have a noticeable impact on the economy.

Chapter II posits that population growth in Saudi Arabia may be the driving force behind eventual regime destabilization. Of all the factors under royal family control, the military, judiciary, and media, it cannot control the birthrate. Civil service jobs still

dominate the economy at 63% since 1990. This chapter illustrates who works in the economy and which sectors are efficient capital producers. It also emphasizes the government's inability to provide a range of benefits to the population, a key to its ruling legitimacy.

Chapter III will go deeper into the Saudi economy and explore why Saudi Arabia is going bankrupt with such reserves of oil resources. This chapter points to a need for economic reform in order to respond to the increasing pressures placed upon it by a rapidly growing population. Where is the money going? Lack of taxation combined with a mixture of religious ideals and inhospitable conditions for Foreign Direct Investment (FDI) have hobbled the Saudi economy in its effort to diversify and privatize. This chapter underscores the royal family's current lack of fiscal responsibility as well as its attempts to reform.

Chapter IV considers the current political climate and investigates the Saudi regime make up. Current requirements for stable government cooperation among the princes, a stable economy, and the task of showing support for U.S. policies in the region while at the same time providing support for its Arab neighbors are among the many decisions the regime must face today. Ascension to the throne is unsteady at best. This chapter compares internal Saudi opposition to institutional reform and regime make up. It illustrates how demographic pressures influence elements of the Saudi regime, both opponents and promoters of reform.

I will conclude with my findings. Will reform efforts be enough to stream line the Saudi economy and allow it to keep up with a growing population? How will these efforts affect future ascensions to the throne? The ability to provide, the protection of Islam, and maintaining a healthy relationship with the U.S. for protection are among the strongest arguments the royal family possesses for legitimate rule; their ability to provide being by far the strongest. The current population growth most directly and uncontrollably affects the ability of the economy, and in turn, the government's ruling power.

## **B. A HISTORY OF U.S. AND SAUDI ARABIAN RELATIONS**

A history of U.S./Saudi relations provides a backdrop and possible insight to current Saudi Arabian economic difficulties. This relationship began during the First World War when America was a net oil exporter and responsible for supplying its allies, now cut off from oil reserves, with a stable supply. Throughout this period the U.S. pursued an open door policy concerning the oil market and its commercial interests rather than acquiring new oil reserves; the British, French, and Dutch oil monopoly in Iraq through the 1920 San Remo Agreement and Treaty of Sevres threatened to lock the U.S. out of budding oil markets.

The oil glut of the 1930's, brought on by a global depression and expanding oil market, decreased official U.S. interest in oil in the region. Standard Oil Company of California (Socal), with little fanfare, secured America's first oil concession in Saudi Arabia by 1933.

From the perspective of Saudi ruler King Abd al-Aziz, Saudi Arabia needed revenue due to a lack of Hajjis from the war and affects of a world depression. The Kingdom and the U.S. benefited from commercial interests without the side affects of political or military interference that was common to colonial associations at the time. Even after the first commercial quantities of oil were produced in 1938 the U.S. showed no official interest.<sup>1</sup>

In 1943 California Arabian Standard Oil Company (Casoc), established in 1933 as a subsidiary of Socal, turned to the U.S. government for assistance in supporting increasing Saudi demands for loans and advances on future production. America finally justified official aid to the Kingdom that year in light of its massive estimated reserves, strategic location, and, by 1944, America's concern of becoming a net oil importer.

The government attempted to buy out Casoc, who resisted, and come to an understanding with the United Kingdom, which also failed, to secure and exploit Saudi oil reserves.

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<sup>1</sup> Long, David E. "The United States and Saudi Arabia: Ambivalent Allies." Middle East Research Institute. University of Pennsylvania, 1995, pp. 19-20.

Exclusive U.S. commercial and wartime interests in Saudi oil fields ebbed after World War II in favor of the new nationalistic threat posed by the Soviet Union. Official U.S. involvement increased dramatically with assistance to Exxon-Mobile in 1948 to acquire shares in the Arabian American Oil Company (Aramco), created in 1944 from Casoc, and a 1950 negotiation of a 50-50 profit sharing agreement between Aramco and Saudi Arabia. While this increased state-to-state involvement benefited both U.S. markets and military operational interests, the momentum initiated with the Soviet Union.<sup>2</sup>

U.S./Saudi relations evolved further in the 1960's due to another oil glut in response to increased U.S. and foreign oil field development and the formation of OPEC. The oil companies, not the oil producing nations, had previously stabilized the oil market by increasing or decreasing production quotas. The total lack of sovereign control over natural resources instigated individual countries, lead by Libya in 1970, to exert control over these foreign oil companies.

This lead the U.S. to deal piecemeal with major oil exporters like Saudi Arabia and by 1973 Saudi Arabia had laid the groundwork through the General Agreement on Participation for countries to own 100% of their upstream oil operations.<sup>3</sup> By 1974 Saudi owned 60% of Aramco and by 1980, 100% nationalized.

### **1. Saudi Arabia's Interaction with the Global Economy**

While independent oil companies dictated world oil markets, the U.S. didn't require an official relationship or energy policy with Saudi Arabia. World oil markets saw to the stable flow of oil. Not even the nationalization process of oil concessions and production quotas stimulated a formalized U.S. policy with the Royal family.

This all changed with the Saudi led oil embargo in the fall of 1973. Due to a 200% increase in price per barrel of oil in a little under three months, the standard of living in America was hit hard. Personal travel freedoms were suddenly taken away. This initiated conservation techniques, investment into alternate forms of energy, and perhaps most importantly, the suggestion by Secretary of State Henry Kissinger to respond

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<sup>2</sup> Ibid, pp. 19-22.

<sup>3</sup>Ibid, pp. 25-26.



militarily to reinstate a stable flow of oil.<sup>4</sup> Even though the embargo was called off early the next year, the necessity for an official U.S./Saudi energy policy had been made clear.

In 1980 Saudi Arabia raised marker crude from \$19 to \$26/bbl in response to the Carter administration halting imports from Iran due to U.S. hostages being held there. By late 1980 Kuwait, Iran, and Libya cut production within OPEC to just 27 million barrels per day (M bbl/d.) This allowed an increase of Saudi Light to \$28/bbl and then to \$34/bbl by 1981. This represented the peak of Saudi oil revenue.

Since Saudi Arabia began nationalizing its oil sector and initiated economic planning in the 1970's, it is interesting to note that it entirely closed its economy to outside investors. It was assumed, due to the rise in oil price, that the kingdom could become self-sufficient and maintain its net exporter status. The first two [five year plans] concentrated on the infrastructure of roads, electrical grids and desalinization plants. Highways, seaports, and power generation were among the most heavily invested. The third plan, covering 1980-5 began to concentrate on education, health and social services. During this time frame, similar to present conditions, oil made up 90% of Saudi exports and 75% of government revenue. Oil also accounted for almost 70% of GDP; the Saudi regime has made progress in their efforts of diversifying the economy of which oil now accounts for 35-40% of GDP.<sup>5</sup>

By the beginning of 1982 non-OPEC producers had reached a production level of 20M bbl/d and OPEC began to lose control of the world oil market. In 1983 OPEC realized that an oil glut had been created and agreed to limit production to 17.5M bbl/d and decrease the price per barrel by \$5 to \$29/bbl.

Years of high oil prices had forced countries to examine not only other sources of oil, but to invest and research alternative energy sources altogether. OPEC hit a 20 year oil production low of 13.7M bbl/d in 1985 in order to maintain \$28 bbl but by December OPEC again increased production to 18M bbl/d to incite a price war allowing them to strike against non-OPEC players; by 1986 world oil prices had fallen by 50%. OPEC

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<sup>4</sup> Al-Naimi, Ali I. "Saudi oil policy combines stability with strength, looks for diversity." *Oil & Gas Journal* Tulsa, Jan 17, 2000, pp. 16-18.

<sup>5</sup> Energy Information Administration. "Chronology of World Oil Market Events 1970-2000, pp. 3-8.

members then reached an agreement by the end of 1987 to cut production to 16M bbl/d and increased the price of oil to a target of \$18/bbl.<sup>6</sup>

Fluctuation in the Saudi economy remained throughout the 1980's as a result of Saudi Arabia trying to maintain the leading market share within OPEC while at the same time trying to keep the world price of oil as high as possible. Three relationships of which Saudi Arabia is constantly aware, the cooperation within and without the Persian Gulf OPEC producing nations, the non-OPEC producing nations of Canada, Venezuela, Mexico, and Russia, and with its main export markets of Western Europe, the United States, Japan, and the emerging Asian markets.

The next spike in oil prices began at the onset of the Iraqi invasion of Kuwait in August of 1990. Oil soared to \$33/bbl as U.S. markets panicked. With assurance from the U.S., Japan, and Western Europe, and an informal agreement within OPEC to increase output, prices soon settled back down to \$18/bbl by the end of the month. Throughout the 1990's oil remained around \$15-\$18/bbl. By 1998 non-OPEC producers, tired of Middle East constraints, came into their own and world oil production increased by 2.25M bbl/d.

Saudi Arabia decided to flood the market again in order to maintain market share and put, specifically, Venezuela back in its place. This price war, in addition to a poor performing Asian market and a couple of unusually warm winters, produced oil prices as low as \$8/bbl. In response OPEC incited production cuts amounting to 4.3M bbl/d, this, along with world demand, caused the price to triple between January 1999 and September 2000.<sup>7</sup>

Since then world oil prices have fallen to weak demand, due to economic recession within the U.S. and OPEC overproduction. However, just recently oil prices have risen due to OPEC production cutbacks and the threat of war in the Middle East. For the month of September 2002 oil averaged \$26.9/bbl. Oil prices are estimated to remain

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<sup>6</sup> Ibid, p. 9.

<sup>7</sup> EIA, International Energy Outlook, April 1997, pp. 157-160.

EIA , International Energy Outlook, April 2000, pp. 140-150.

EIA , International Energy Outlook, March 2002, pp 38.

at \$30/bbl for the remainder of 2003 and then rapidly fall to \$26/bbl and remain their out to 2005. From there, oil prices are expected to rise gradually to about \$27-28/bbl by 2020.

### **C. THE UNIQUE IMPORTANCE OF SAUDI ARABIA**

Total U.S. imported oil is projected to increase from 10.7M bbl/d in 2000 to 18.2M bbl/d in 2020 while U.S. imports from Saudi Arabia alone will increase from 2.6M bbl/d to 4.9M bbl/d respectively.<sup>8</sup> World energy consumption is expected to increase 60% by 2020 with oil accounting for 40% of this. Natural gas accounts for the remainder, mainly for electrical generation.

World oil consumption is projected to increase from 75M bbl/d in 1999 to 119M bbl/d in 2020 with the transportation sector requiring upwards of 75% of this increased oil demand. Per capita motorization in the developing world is estimated to more than double between 1999 and 2020.

In 1999 developing nations consumed 58% of oil used in the industrialized world, by 2020 this will grow to almost 90%. This use of oil is tied directly to the industrialized growth of their economy. Since the U.S. depends on a strong global economy, it is in its national interest to insure the economic health of these countries and ensure the reliable increased flow of oil that they will require.

This is not the case with industrialized nations; their economy is not as closely tied with oil where energy demand has lagged behind economic growth. Industrialized nations are dependent upon the developing countries of the world for their own continued growth.

In support of the above predictions, the International Energy Outlook 2001/2002, Global Insight (formerly DRI-WEFA), International Energy Agency, Petroleum Industry Research Associates, and Petroleum Economics Ltd. all conform to within .1% of their

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<sup>8</sup> **IEO2002**: Energy Information Administration (EIA), World Energy Projection System (2002). **IEO2001**: EIA, International Energy Outlook 2001, DOE/EIA-0484(2001 (Washington, DC, March 2001), Table A1, p. 169. **DRI-WEFA**: (Data Resources Inc - Wharton Econometric Forecasting Associates), World Energy Service: World Outlook 2000 (Lexington, MA, January 2001). **IEA**: International Energy Agency, World Energy Outlook 2000 (Paris, France, November 2000), pp. 364-418. **PIRA**: PIRA Energy Group, Retainer Client Seminar (New York, NY, October 2001). **PEL**: Petroleum Economics, Ltd., Oil and Energy Outlook to 2015 (London, United Kingdom, June 2001).

average annual percentage growth predictions for the 1997-2010 period of 2.0%.<sup>9</sup> Saudi Arabia, not including the Saudi-Kuwaiti Neutral Zone, holds over one quarter of the world's total proven oil resources at 262 billion barrels. Oil reserves in the Middle East (including North Africa) account for 76.8% of the world's total, of this, Saudi Arabia contains one third. Only 22.6% of global oil reserves exist outside the ME.<sup>10</sup>

With such large reserves and guaranteed current and future export markets, the least of Saudi Arabia's concerns would seem to be economic. The Persian Gulf's share of worldwide petroleum export is estimated to increase to 60% by the year 2020. Saudi oil production capacity alone will need to increase from 14.5% of the world's supply in 2000 to 19.2% by 2020. The Persian Gulf provided 34.9% of world export in 2000; this is projected to increase to 47.2% by 2020, an equivalent regional increase of exports by 126%.

In total, exports Saudi Arabia alone will increase its production from 12.1% of world oil production in 2000 to 18.2% in 2020, and from 43.3% of Persian Gulf capacity to 51.5% over the same time period.<sup>11</sup> In addition to future world oil demand and extensive Saudi oil reserves, the current Saudi oil infrastructure, while less robust than 1980 levels, is producing well below its capacity. Saudi's June 2003 OPEC quota of 8.2M bbl/d is well below its 11M-bbl/d capability.<sup>12</sup> The Saudi east-west oil pipeline to the Red Sea is transporting less than half of its 5M-bbl/d capacity, as are Saudi export terminals in the Persian Gulf that are capable of 14M-bbl/d.

Saudi Arabian production, discovery, and expanding production costs are only a fraction of what they are outside the Gulf region. Saudi production costs average around \$1.50/bbl while costs to produce 1bbl of oil outside the region range from \$5-\$10/bbl.

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<sup>9</sup> EIA, International Energy Outlook, April 1997, pp. 157-160.

EIA, International Energy Outlook, April 2000, pp. 136-140.

EIA, International Energy Outlook, March 2002, p. 38.

<sup>10</sup> Cambridge Energy Associates. "World Oil Trends." Cambridge, Mass: 1998, pp. 26-27.

<sup>11</sup> Cordesman, Anthony H. *Transnational Threats From The Middle East: Crying Wolf or Crying Havoc?* Strategic Studies Institute SSI, 1998, pp. 221-230.

<sup>12</sup> Al-Naimi, Ali I. "Saudi oil policy combines stability with strength, looks for diversity." Oil & Gas Journal Tulsa, Jan 17, 2000, pp. 16-18.

Costs of oil discovery within Saudi Arabia are now as low as \$.10/bbl and, over the past two decades, 3 barrels of oil were discovered for each barrel produced. The costs to discover oil outside the Gulf range up to \$4/bbl. Due to the location and ease of extraction, all encompassing costs to increase production by 1-bbl/day in Saudi Arabia peak at about \$5,000 while the same costs expand to \$10-20,000/bbl outside the Persian Gulf region.<sup>13</sup>

Why, with all of Saudi Arabia's proven oil resources, export markets, and a requirement to increase production for the world market is the per capita standard of living steadily dropping? From a strictly oil supported per capita GDP, Saudi Arabia once rivaled that of the United States. Since 1980 this has dropped from an amazing \$23,820 to just \$2,563 in 2001.<sup>14</sup>

What are the driving factors behind this massive swing? The following will examine and contrast the "Golden Age" of Saudi Arabia in the 1970's to present day. Tracking GDP growth, deficit spending, oil production capacity, and various reasons for falling oil prices, will shed light on current Saudi economic difficulties. The history of fluctuating oil markets points to the importance of economic diversification. Is the Saudi Arabian economy held hostage to world oil demand? Are current economic difficulties of the Saudi government's own making? Finally, what is the Royal Families proposal for the future? Will the opening of doors to FDI, education of the Saudi workforce, and an increase of production from the private sector allow Saudi Arabia to become a modern industrial state?

#### **D. SAUDI ARABIA'S BASIS OF RULE**

The Royal family bases its legitimate right to rule on two foundations: as the protector and supporter of religious Islam; and, an all-encompassing social provision to provide benefits to the Saudi population. Royal Family foundations in Islam date back 290 years when the Royal family allied itself and overtly funded the severe Wahhabist version of Islam.

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<sup>13</sup> Cordesman, Anthony H. "Center for Strategic and International Studies." Arleigh A. Burke Chair in Strategy. April 2002, p. 2.

<sup>14</sup> EIA International Energy Outlook, April 2000, pp. 23-27.

In 1986 King Fahd added the title “Custodian of the Two Holy Mosques” to his title. The right to rule also lies in the government’s commitment during its third five year economic plan in the early 1970’s to provide for all forms of social service to its growing population by increasing the budget in these areas by over \$100 billion.

Due to the decrease in oil prices from the late 1970’s and steady increase in population, Saudi Arabia has been forced to admit that it is unable to provide for its people as it once could. Saudi Arabia found the decrease in oil prices in 1982 unsettling but by 1986 it was viewed as a crisis. The thought of financial austerity measures in the fourth five-year economic plan threw the population into frenzy. King Fahd proposed a national Consultative Assembly in order to allow greater participation in the government to counter the proposed budget cuts. This relative ‘taxation’ in exchange for representation was abandoned due to an overestimated drop in oil prices. The budget cuts and increased participation did not occur and the status quo was maintained, but it remains unclear whether this status quo can be maintained indefinitely.

The diverging paths of GDP and population growth are perhaps the most serious indicator of economic instability. Between 1995 and 1999 the GDP average growth in Saudi Arabia was .8% per year while the average population growth rate was between 3.1-3.5%. Real GDP per capita during the same time frame decreased from \$9,341 to \$8,432. Much of the real GDP growth is accounted for by oil related industry, where an estimated 40% of the real GDP comes from the private sector.

In 2000, when the world economy increased the price of oil, the Saudi Arabian oil sector GDP increased by 8.5% while the non-oil sector increased by only 2.6%. In order to balance the budget the Saudi economy currently has to produce 8M bbl/d and receive \$22/bbl. Saudi Arabia's 2002 OPEC quota of 7.1M bbl/d and a weighted world average of just under \$20/bbl make this goal impossible. Due to the recent OPEC quota increase in 2003 to 8.2M bbl/d and the 2003 EIA/IEA prediction of oil prices to remain well above \$25/bbl for the foreseeable future, the Saudi budget may stabilize in the short run.

While the ruling elite now have room to maneuver it is unlikely that any reforms will be initiated that will upset the balance of power. It is predicted that Saudi Arabia will

still have to spend on average 6% over its GDP per year in order to break even until 2005 at the earliest. In short, while relative solvency is possible in the short term, economic stability in Saudi Arabia is at the mercy of world market forces.

The Royal family cannot rely on the Saudi oil industry to pump enough oil to support its budget of which 65% goes to paying government salaries. It certainly cannot expect it to cover all oil and civil infrastructure development costs that will be necessary to for the country to function in the next decade. In addition, it is estimated that \$100 billion is required to be invested immediately in order to maintain the current deteriorated infrastructures in the desalinization and power producing sectors to provide for the population of 2020 that will almost double from its current 2003 midyear figure of 24 million.<sup>15</sup>

Due to a conservative population growth estimate of 3%, lack of industrial privatization, single resource dependency, and fear of Foreign Direct Investments (FDI) that are essential for the necessary economic growth, the Saudi economy will continue its downward spiral without reform.

This will degrade the security of not only the U.S., but countries within the Persian Gulf as well. In addition to becoming a haven for Islamic fundamentalism, the fall or even destabilization of the Royal Family will further decay the existing oil producing infrastructure. A collapsed Saudi regime, which is currently experiencing uncertainty in its succession and advanced aging among its elites, would almost surely be replaced by some form of conservative Islamic based government.

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<sup>15</sup> U.S. Bureau of the Census, international Data Base at <http://www.census.gov/cgi-bin/ipc/idbsprd>, accessed October 2003.

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## **II. CURRENT AND PREDICTED POPULATION GROWTH RATES**

### **A. INTRODUCTION**

The difficulty in tracking population growth rates and per capita GDP trends of Saudi Arabia lies within its closed society. Throughout the 1970's and 80's the official Saudi government census reports were inflated to represent a population that didn't exist. From the start of the oil boom in the 1970's it wasn't Saudi Arabia's lack of population but its lack of a modern workforce that, along with its roots in a nomadic lifestyle versus one of manufacturing, constituted the primary weaknesses of the Saudi economy.

### **B. THE FOUNDATION OF ECONOMIC PLANNING**

The influx of oil wealth into the kingdom in the 1970's introduced the possibilities of a more materialistic lifestyle and created offshoots of the existing class structure. The "mechanized Bedouin" exchanged their camels for cars yet retained their roving lifestyles while "Cultural brokers" were created by the integration of east and western societies that oil wealth fashioned. Mohamed el-Sayed, an instructor at the Al-Ahram Center for Political and Strategic Studies in Cairo stated, "Ordinary people felt forced to take advantage of the oil wealth, and for intellectuals oil was a disaster. It corrupted Arab society, steering it toward hedonism and consumerism. It opened a door to a life my generation can't relate to. What about self-reliance and hard work?"<sup>16</sup> To many, oil represented a grace from God, something that was perhaps owed to the Arab people for past transgressions against them.

In 1960 Saudi Arabia had an illiteracy rate of 70%, two thirds of which were women. By 1987, while most of the population was being educated, only 1.5-3.6% of university students held vocational degrees. Almost three-quarters of all university graduates held non-technical degrees and gravitated towards guaranteed civil service employment. Today, 88% of the male population and 74% of the female are literate; however, 30% of the Saudi population still remains unschooled. The regime's goal of

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<sup>16</sup> United Nations Development Program. "Creating Opportunities for Future Generations." Arab Human Development Report, 2002, pp. 45-49.

increasing the Saudi percentage in its own work force is carried on through the seventh economic plan (2000-04) which has set a target of creating over 800,000 new jobs for Saudi nationals, almost the entire amount of available unemployed.<sup>17</sup>

Saudi economic strengths in the 1970's consisted of generous natural resources and a relatively, regionally speaking, large population. Regime aspirations in the first economic plan of 1970 were to work towards lessening the effects of an oil dependent economy. This diversification was to be accomplished through capital-intensive industry and advanced technologies; much like what Israel is involved in today. The short-term goal was to import foreign labor until native Saudis could be trained to replace them.<sup>18</sup>

During the first five-year economic plan manpower planning and development became a national priority due to the massive economic developments in, and related industries to, the oil sector. The initial plan estimated labor requirements at 1,180,000 of which native Saudi's would account for 84%, largely as unskilled labor. Over 170,000 foreign skilled laborers had to be imported. Even with this influx of foreign labor the first economic plan fell short of required skilled labor by 169,000 workers.<sup>19</sup>

In 1979 the Saudi population of 9.3 million could not generate the requisite skilled labor force to meet the demands of rising oil production and associated infrastructure requirements. A misrepresentation of the actual population was manipulated to project strength from both an economic and religious Islamic standpoint.

From 1980-85 (the third economic plan) generating requisite manpower levels had taken precedence over all other matters. Two techniques that were instituted during this time, and still being implemented today, were the improvement of the education and training system in order to increase the native Saudi supply of skilled labor and the regulation of immigration into the foreign labor supply.

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<sup>17</sup>Cooper, Roger. "Saudi Arabia: The Making of an Industrial Power." *Euromoney*. October 1982, pp. 25-28.

<sup>18</sup>Al-Dosary, Adel S. - Garba, Saibu Bala. "Inter-organizational coordination: A case study of the education and training system in Saudi Arabian manpower planning HR." *Human Resource Planning* vol. 20, 1998, pp. 10-12.

<sup>19</sup>Looney, Robert E. "Factors Affecting Employment in the Arabian Gulf Region, 1975-85." *International Journal of Social Economics*, Vol.19, 1992, pp. 43-47.

The first strategy focused on specialized vocational schooling while the second increased the cost, through immigrant related paper work and newly proposed taxation, to a Saudi or foreign employer wishing to employ foreign labor. Foreigners made up an estimated three-quarter of the Saudi work force by the end of the third economic plan.

Issues facing the Saudi regime to replace its workforce with Saudi natives include the obvious presence of foreign workers who represent the bulk of skilled labor, the abundance of young unemployed and unskilled Saudi natives, the potential untapped female workforce, and a culture which looks down upon menial and labor intensive occupations. Future efforts to lower native Saudi unemployment will hinge upon the expenses required to educate upcoming generations, the provision of jobs from the private sector, and the added unpredictable pressures of maintaining stable revenues from oil and an explosive population growth.<sup>20</sup>

### **1. Increased Growth Finds Saudi Arabia Unprepared**

By the 1990's the tide had turned and Saudi Arabia possessed the numbers to take back its labor force. However, the already established education and division of labor structure wasn't equipped to absorb them due to the already large percentage of foreign workers in country which stands currently on the conservative side of 53% in 2003. This traditional Saudi reliance upon foreign labor and exclusive oil wealth subsidies for its nationals needs to be addressed before the economy can stand on its own.

As an example, in 1990 a full one-third of Aramco's employee's were Shi'ia when the Shi'ia only accounted for 8% of the Saudi population. Although the Shi'ia are counted as Saudi nationals, they are looked down upon as second-class citizens and therefore expected to work in labor-intensive fields. The average Saudi considers himself above such employment. In fact, only one in four persons in the private sector today are Saudi citizens.<sup>21</sup>

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<sup>20</sup> Taecker, Kevin Rollin. "Myths And Realities About Unemployment in Saudi Arabia." The Saudi-American Forum. Info@SaudiAmericanForum.net, accessed September 2003, pp. 2-4.

<sup>21</sup> Kanovsky, Eliyahu. "The Economy of Saudi Arabia: Troubled Present, Grim Future." The Washington Institute for Near East Policy, 1995, pp. 41-48.

Census reports began to underestimate the population in order to down play predicted economic pressures caused by high growth rates and overpopulation stresses. Although differences do exist between official Saudi and independent foreign census reports, they seem to be converging. In 1992 conformity between official Saudi reports of 12.3 million Saudi nationals to 4.6 million foreign workers, for a total population of 16.9 million, closely matched with a U.S. Bureau of Census report of 16.7 million total populations that also concurred with the Census Bureau's estimate of a 3.7% growth rate.<sup>22</sup>

The following population, economic financial figures, and growth rates are taken from the U.S. Bureau of the Census International Data Base, the World Bank, EIA, U.S. State Department, and from individuals currently working within Saudi banking and finance institutions.<sup>23</sup> Figure 1 at the end of this chapter provides an indication of current and near future population trends.

The current Saudi population of 2003 stands roughly at 24 million and is expected to grow to 28.6 million and to 40.6 million by 2008 and 2020 respectively. While growth rates have decreased from 4.9-4.7% in the 1970's and 80's, they are expected to remain constant at 3.2-3.3% out to 2020. This growth rate could be attributed to a lack of state funded birth control programs and the influence of Islamic tenets, but more accurately, the number of deaths per 1000 individuals has decreased 50% from almost twelve in 1980 to less than six by 2000 while births per 1000 individuals have only decreased about 15% from 44 to 37.<sup>24</sup>

The topic of birth control has not yet entered the public domain in Saudi Arabia where abortion is illegal. In Tunisia, another Islamic country, a population growth program has been enacted and showing some measures of success.<sup>25</sup> The Arab world in

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<sup>22</sup> Janet Matthews Information Services - Quest Economics Database – Technical Review Middle East, <http://web.lexis-nexis.com/universe/document>, accessed January 2003.

<sup>23</sup> <http://www.census.gov/cgi-bin/ipc/idbsum?cty=SA>, accessed October 2003.

<sup>24</sup> Janet Matthews Information Services, Quest Economics Database Nov 15, 2002 "Special Report Saudi Arabia: Pause for thought." p. 23.

<sup>25</sup> Liesman, Steve. "Low Oil Prices Take Toll on Saudi Arabia --- Economic Impact Worsened By Population Boom; Intervention Is Denied." Wall Street Journal. March 1999, p. A13.

general recognizes large families in general as a sign of prestige. In a region with less than reliable social welfare programs large family structures with many working children are required to provide financial security.

The fertility rate in Saudi Arabia by 2000 stood at 6.4 children per woman; in 1999 Saudi Arabia had the 20<sup>th</sup> largest growth rate in the world with Afghanistan being the only country with both more people and a higher growth rate.<sup>26</sup> These numbers work out to six dependents for one Saudi national while expatriates workers average 0.7 dependents per worker. This also indicates the extent of expatriate income that leaves the Saudi economy directly to the families of these workers.

In addition to continued high growth rates, it is interesting to note that over 50% of the population in Saudi Arabia is now less than 25 years of age with 42% of it being under the age of 15. These figures are double those of 1980 and are projected to almost double again by the year 2020. More disturbing than a growth rate above 3% is this upcoming generation of Saudi youth who will reach childbearing age within the next five years.

## **2. “Saudization”**

As noted above, Saudi Arabia’s problem is no longer one of under population but of native Saudi participation in the work force. Independent reports estimated that less than a million Saudi nationals, including women, participated in the Saudi workforce in the late 1970’s. The native Saudi work force made up only 10% of the total population of 8.6 million in 1978; 3.6-4.0 million of the work forces were estimated to be foreign.<sup>27</sup>

The government in Saudi Arabia today is attempting to replace foreign workers with Saudi nationals by requiring all foreign and domestic businesses to ensure their employees are made up of 25-30% Saudi nationals. Due to foreign willingness to work for lower wages and in menial jobs, it costs on average about one-third less to higher a

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<sup>26</sup>Kanovsky, Eliyahu. “The Economy of Saudi Arabia: Troubled Present, Grim Future.” The Washington Institute for Near East Policy, 1995, pp. 45-48.

<sup>27</sup>Saudi Arabia, “Forecast Scenarios,” <http://www.prsonline.com>, accessed January 2003.

foreigner over a Saudi citizen. A 'saudization' plan was put into effect in 1996 for any company with 20 or more employees in order to overcome this reluctance to hire domestic workers.

The initial percentage of required Saudi natives was 5% and has increased 5% annually to its current requirement of 30% in 2003.<sup>28</sup> This stress of employing more Saudi nationals will fall upon the larger companies, which designates foreign firms and the Saudi government itself. Saudi nationals have traditionally enjoyed higher wage compensations, almost double, than foreigners with equivalent educations. Also, foreign labor entering the more physical or menial labor market is willing to accept a much lower wage than his Saudi counterpart. For institutions such as Banking and finance, which tend to fill up faster than other sectors in the economy, Saudi's occupy up to 80% of all positions. Local bankers have expressed concern that if saudization is to continue, the quality of management will be diminished.

The Saudi government is attempting to reverse the appeal for expatriate labor by imposing increased costs on immigrant certification and additional government fees for employing foreigners. The hiring field between Saudi nationals and foreign labor is also being leveled by the inevitable decrease in standard wages across the board due to an attempt to employ the upcoming generation of Saudi's without an accompanying job market to absorb them.

Today's Saudi population of 24 million is made up of 6.4 million foreigners and 17.6 million Saudi natives. The total work force of 10 million consists of 5.3 million foreigners and 4.7 million natives. Of this workforce, less than 20% are women with only one in ten of these being Saudi nationals. Only an estimated 2% of female Saudi citizens are employed. This lack of women in the workforce puts the Saudi national contribution to the workforce at a mere 21-22%, less than half the average for the Middle Eastern region whose workforces are made up of almost 50% of their total population.<sup>29</sup>

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<sup>28</sup> Saudi Arabian Information Resource – Civilian Employment <http://www.saudinf.com/main/e14.htm>, accessed September 2002.

<sup>29</sup> Taecker, Kevin Rollin. "Myths And Realities About Unemployment in Saudi Arabia." The Saudi-American Forum. [Info@SaudiAmericanForum.net](mailto:Info@SaudiAmericanForum.net), accessed September 2003, pp. 2-4.

### **C. HOW TO INCORPORATE SAUDIS INTO THE WORKFORCE**

While unemployment for foreigners is less than 1%, overall unemployment for Saudis is officially reported at 8%. This 8% is 'disguised' since it does not include the social welfare, government subsidized programs, or homemakers within the society. Figure 2 included at the end of this chapter indicates a more realistic rate of unemployment in an oil-based economy in which the oil industry, the majority of which are foreigners, employs less than 2% of the workforce.

Independent consultants working on economic reform within the kingdom project a more realistic unemployment rate. The presently employed generation of 25-34 year olds is currently unemployed at 27% and 33% for males and females respectively.<sup>30</sup> The up and coming workforce of 15-25 year olds represent half of the entire Saudi population, most of which reside in the country's educational system. Over the next ten years an additional 10-12 million workers will have to be accounted for and gainfully employed.

The automatic acceptance of Saudis into the civil service, military, and National Guard are no longer viable employment options for the Royal Family. Brad Bourland, the chief economist at Saudi American Bank (Samba) estimated in 2000 that the number of employable Saudi citizens entering the workforce is growing by 6% annually.<sup>31</sup>

Incorporating its native population into the workforce today could solve many of Saudi Arabia's problems. Even if the entire eligible male and female population of Saudi Arabia were to be utilized, they would still only break even for the required 10 million workforces of 2003. This assumes no unemployment and doesn't address the mothers and fathers who would have to stay home to maintain a household. The indication is, even if every reasonably available man and women in Saudi Arabia were employed, the Saudi workforce would still have to be supplemented by a small contingent of foreign labor.

The Saudi government's intention is to decrease the foreign work force by 2-3% over the span of the seventh (2000-2004) economic plan. It's estimated that by 2004 this saudization process could show a \$4.6 billion increase in domestic Saudi wages by

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<sup>30</sup>Moore, Phillip. "The kingdom looks beyond oil." *Euromoney*. September 2000, pp. 294-300.

<sup>31</sup>Taecker, Kevin Rollin. "Myths And Realities About Unemployment in Saudi Arabia." *The Saudi-American Forum*. [Info@SaudiAmericanForum.net](mailto:Info@SaudiAmericanForum.net), accessed September 2003, pp. 9-11.

simply transferring money paid to foreigners, of which almost none is spent inside Saudi Arabia, to Saudi nationals who would spend almost all their earnings within Saudi borders.<sup>32</sup> Economic plans and governmental intentions aside, how is the current population of Saudi Arabia stressing its economy?

#### **D. DEMOGRAPHIC STRESSES ON THE SAUDI ECONOMY**

Oil in Saudi Arabia accounts for 90% of its exports, 40% of GDP, and 75% of the government's revenue. It will continue to provide a reliable economic base for at least another century at current production rates and known recoverable reserves. The problem is that Saudi Arabia's combined current foreign and public debts are equal to nearly 100% of its estimated 2003 GDP of \$190 billion.

This accumulation of debt can be attributed to poor spending habits in the past. During the oil boom in the early 1970's it wasn't expected that Saudi Arabia could possibly increase public spending to absorb its newfound capital. However, by 1977 Saudi public expenditures were \$39 billion and steadily increased. By 1980 and 1981 public expenditures had increased to \$71 billion and \$84 billion respectively. This increase in spending combined with a decrease in oil revenues, from \$96 billion in 1981 to \$54 billion in 1982, to eat away built up Saudi capital reserves.<sup>33</sup>

A recent increase in oil production quotas granted to Saudi Arabia by OPEC from 7M bbl/d in Jan 2002 to 8.2M bbl/d in June 2003 is expected to turn an estimated budget deficit of \$10 billion for 2003 into a \$13 billion surplus by years end. This illustrates the dependency of the Saudi economy on oil production and market prices.<sup>34</sup> Due to over spending Saudi Arabia experienced budget deficits every year from 1981 to 2000. Public spending for the sixth economic plan was overshot by \$33 billion in 1999 and the second year of the seventh plan, 2002, was over budget by \$15 billion.

In 2000 total oil exports equaled \$72 billion but the government reported oil receipts that only amounted to \$57 billion. Saudi ARAMCO absorbed the difference with

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<sup>32</sup> Kanovsky, Eliyahu. "The Economy of Saudi Arabia: Troubled Present, Grim Future." The Washington Institute for Near East Policy, 1995, p. 31.

<sup>33</sup> <http://www.eia.doe.gov/cabs/saudi.html>, accessed March 2003.

<sup>34</sup> Janet Matthews Information Services - Quest Economics Database – Technical Review Middle East – January 29, 2003 <http://web.lexis-nexis.com/universe/document>, accessed February 2003.



the assumed excess going to royal family stipends. Another source of income leaving the country is from flight capital invested abroad by the Al-Saud hierarchy. Total investments outside Saudi Arabia are estimated between \$800 billion and \$1 trillion, equal to an estimated 422-528% of its annual GDP.<sup>35</sup>

In the last couple of years, mainly due to a recent increase in world oil prices, real per capita GDP growth averaged 1.8% from 1998 to 2002. However, GDP growth from 1981 (\$155.1 billion) to 2001 (\$186.5 billion) averaged only 1.25% per year while the equivalent population growth averaged 3.67% per year, from 9.9 million in 1981 to 21.4 million in 2001.<sup>36</sup> The seventh economic plan ending in 2004 projects GDP to average 3.2% (more than twice that of the 1990's.) In actuality, GDP will have to average between 5-6% to balance the budget and provide for upcoming generations.

To focus solely on oil revenues adjusted for inflation, Saudi Arabia's per capita income has fallen from \$23,820 in 1980 to \$2,296 in 2002. While this number isn't entirely accurate of actual money in a Saudi's pocket, (estimated 2002 dollars in per capita equaling \$8,700 per person) it is indicative of a steadily decreasing standard of living.<sup>37</sup> To underscore this point of relative deprivation, between 1972 and 1982, the average consumption increased four fold; by the late 1980's however, it only dropped by one quarter.

Assuming the princes closest to the King probably didn't cut back their standard of living to this extent, this would indicate an ever-increasing gap between the have and have-nots.<sup>38</sup> A fact that underscores this is the continued increase of living standards among the privileged. In 2002 Saudis racked up \$19 billion in credit card bills, an increase of 23% from the preceding year. The average charge for that year came to

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<sup>35</sup> World Bank, "Country at a Glance: Saudi Arabia," <http://www.worldbank.org/transport/rail/rdb/raildata/saudi.xls>, accessed December 2002.

<sup>36</sup><http://www.eia.doe.gov/cabs/saudi.html>, accessed March 2003.

<sup>37</sup>Kanovsky, Eliyahu. "The Economy of Saudi Arabia: Troubled Present, Grim Future." The Washington Institute for Near East Policy, 1995, pp. 29-32.

<sup>38</sup>Raphaelli, Nimrod. "Saudi Arabia: A Brief Guide to its Politics and Problems," MERIA. September 2000, pp. 13-18.

\$8700, a figure equivalent to the per capita income of the average Saudi citizen.<sup>39</sup> Figure 3 at the end of this chapter gives an indication of diverging population and per capita living standards.

The utility infrastructures in both electrical generation and transfer are sorely in need of investment. Attempts to privatize sector ownership in industry, agriculture, power generation, and oil production have made progress but government subsidies are still the rule and not the exception. The Saudi regime still owns a majority of the economy and stock exchange. Although private ownership is being experimented with in companies like Saudi Telecom, Saudi Electric Company (SEC), and Saudi Basic Industries Corp at (SABIC), it has never been allowed into the main oil-producing arena where state owned Saudi ARAMCO has reigned supreme since the 1970's. This is the single largest integrated production, marketing, and refining Oil Company in the world.<sup>40</sup>

The immediate area of concern is of power generation. Electricity Minister Dr. Hashem Ibn Abdullah Yamani, the Minister of Industry and Electricity, projects that \$115 billion of investment is currently required to keep up with power demand which is currently increasing by 4.5% a year. Current Saudi electrical generation of 23.6 GW is estimated to almost triple by the year 2020, this translates to a required yearly investment of \$2-4 billion in order to meet future demand.<sup>41</sup> Furthermore, most of this investment is expected to come from the private sector along with substantial FDI.

In addition to generation, power transmission will also require massive investment. It is estimated that over 20,000 miles of power transmission lines will be required to link all four of Saudi Arabia's power regions together. Current industrial projects have been postponed and power failures in the capital of Riyadh have become commonplace as a result. In attempts to remedy the situation, on February 16, 2000

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<sup>39</sup>Janet Matthews Information Services - Quest Economics Database – Technical Review Middle East – January 29, 2003 <http://web.lexis-nexis.com/universe/document>, accessed January 2003.

<sup>40</sup> EIA, "Saudi Arabia Country Analysis Brief," <http://www.eia.doe.gov/cabs/saudi.html>, accessed December 2002, pp. 6-8.

<sup>41</sup> EIA, "Saudi Arabia Country Analysis Brief," <http://www.eia.doe.gov/cabs/saudi.html>, accessed December 2002, p. 8.

Yamani oversaw the merger of ten existing power companies. In April of 2000 the Saudi government removed all subsidies for electricity, but it's reported that subsidies in fact still exist.<sup>42</sup>

Water, if not an immediate issue, will become Saudi Arabia's utmost concern. Underground aquifers constituted 90% of all Saudi water supplies in 1993 and take hundreds of thousands of years to form. They are projected to run dry by 2015.<sup>43</sup> Current water consumption in Saudi Arabia is currently 15 billion cu/m and expected to increase to 18.3 billion cu/m by 2010 with an annual growth rate of 3%.

The Saline Water Conversion Corp (SWCC) estimates a required investment of \$61.3 billion between 2003-2020 in desalination in order to meet future demand. Saudi Arabia currently accounts for 20% of the world's desalinated water.<sup>44</sup> With less than one quarter of 1% of the Saudi landmass being suitable for agricultural industry, the bulk of available water is being directed towards the urbanized centers. Current strategy in water production focuses on the collection and storage of rainfall, better use and extraction from underground aquifers, and the desalination of seawater.<sup>45</sup>

Another indicator of demographic stress on the Saudi economy is one of energy intensity, or how efficient the economy is using a unit of energy. Developing nations, like Saudi Arabia, are much more dependent on oil for economic growth than a fully industrialized nation like the U.S. The 2001 EIA/International Energy Annual energy intensity estimates for Saudi Arabia were 34,157 Btu/1\$ in 1995 (the amount of energy used to generate one U.S. dollar) as opposed to a U.S. figure of 10,736 Btu/1\$ in 1995. The argument is, even though the U.S. consumes much more oil than Saudi Arabia, a

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<sup>42</sup> Gully Cragg, "Icebergs to Arabia?," *Energy Economist*, London July 1993, pp. 12-14.

<sup>43</sup> Janet Matthews Information Services - Quest Economics Database – Technical Review Middle East – January 29, 2003 <http://web.lexis-nexis.com/universe/document>, accessed January 2003.

<sup>44</sup> Department of Commerce Event To Inform Saudi Arabians of U.S. Advances in Water Technology, *Business America*, Washington Jan 14, 1980 vol. 3 Issue 1, pp. 11-23.

<sup>45</sup> Abdulrahman A Al-Nuaim, Elijah A Bamgboye, Khalid A Al-Mazrou, "Overweight and Obesity in Saudi Arabian Adult Population, Role of Socio-Demographic Variables," *Journal of Community Health*, vol. 22 Issue 3, pp. 211-223.

quarter of world production, the developing infrastructure of Saudi Arabia is under the dual pressures of an increased population load and lack of investment to handle this load as efficiently as possible.

About 86% of Saudi Arabia is urbanized with its two main population centers, Riyadh with an estimated 1.9 million and Jeddah with 1.8 million inhabitants, located around key resource infrastructure areas. The rest of the major urbanized locations like Dammam, Dhahran, Al Khobar, Mecca, Medina, Hofuf, Taif, Jubail, Yanbu, and Abha are also located around major crude oil pipelines like the east-west Petroline that runs from the Persian Gulf to the Red Sea. Those cities that do not follow the pipelines are located around major railways.

Figure 4, located at the end of this chapter, is a 1992 representation of general population distribution and urbanization. It underscores the importance of, and dependence of the upcoming population on, the countries urbanized infrastructure. It also illustrates the future trend of an increasing Saudi urbanized population.<sup>46</sup>

### **1. Economic Potential**

The Saudi government's goal of diversifying the economy isn't as hopeless as it might at first appear. Saudi Arabia has fields of natural gas which rank fourth in the world for reserves, rich mineral deposits to the north, and an increased down stream petrochemical development program.

The population to incorporate a wholly Saudi manned workforce exists but will require a restructuring of the educational system to train upcoming generations, a privatized market economy to provide employment, and a rethinking of traditional employment standards. By employment standards I mean the acceptance of less government subsidization, a lower standard of living for the elite princess, and the necessity not only to demonstrate skill to maintain employment, but to accept necessary labor intensive and vocational careers. The combination of privatization, projected to be

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<sup>46</sup> Ibid, pp. 220-224.

over 50% by 2004, and a saudization rate of 2% a year alone are capable of curing many economic troubles. The current issue isn't a lack of Saudi Arabian pride or initiative, but one of reform.

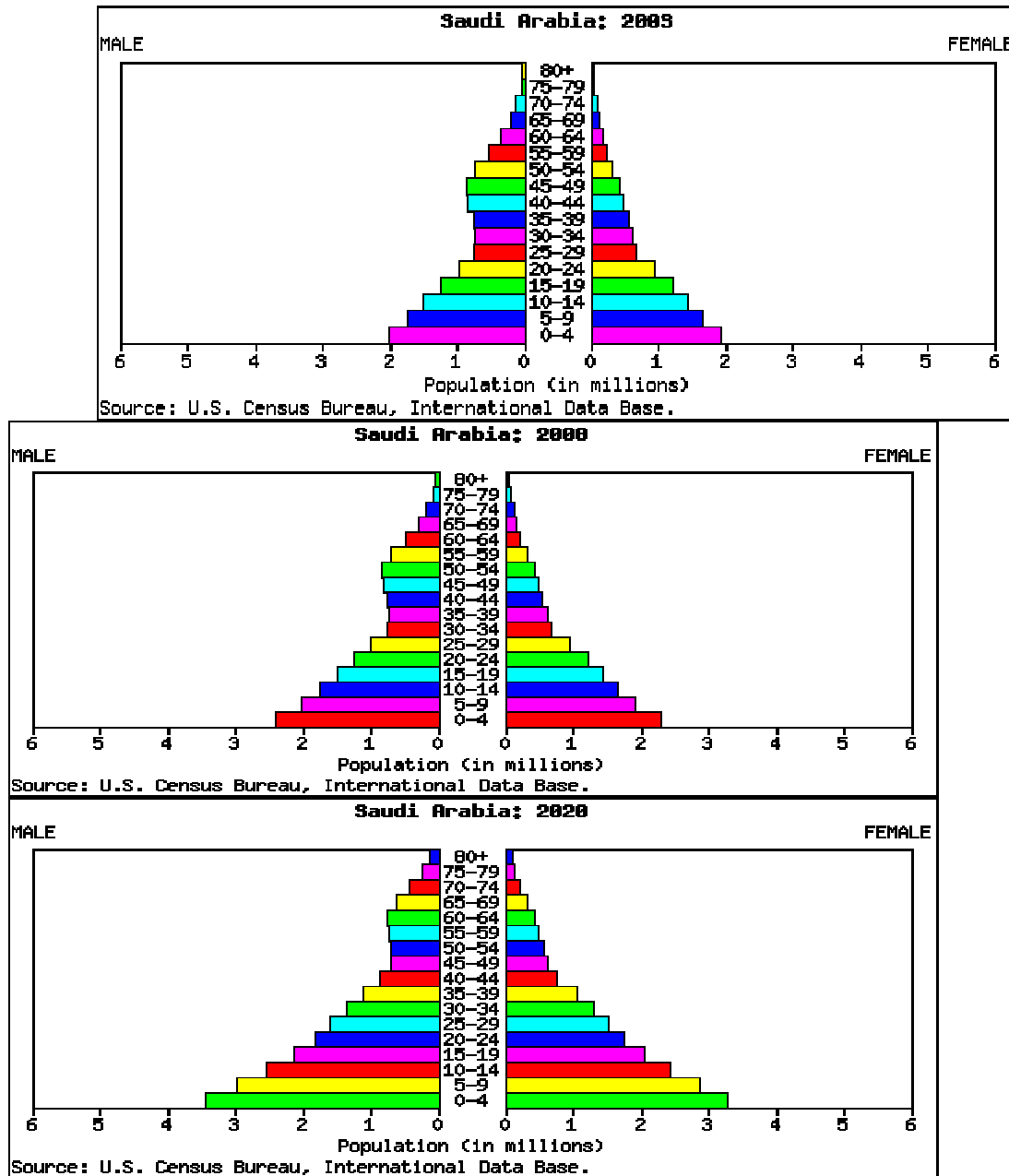
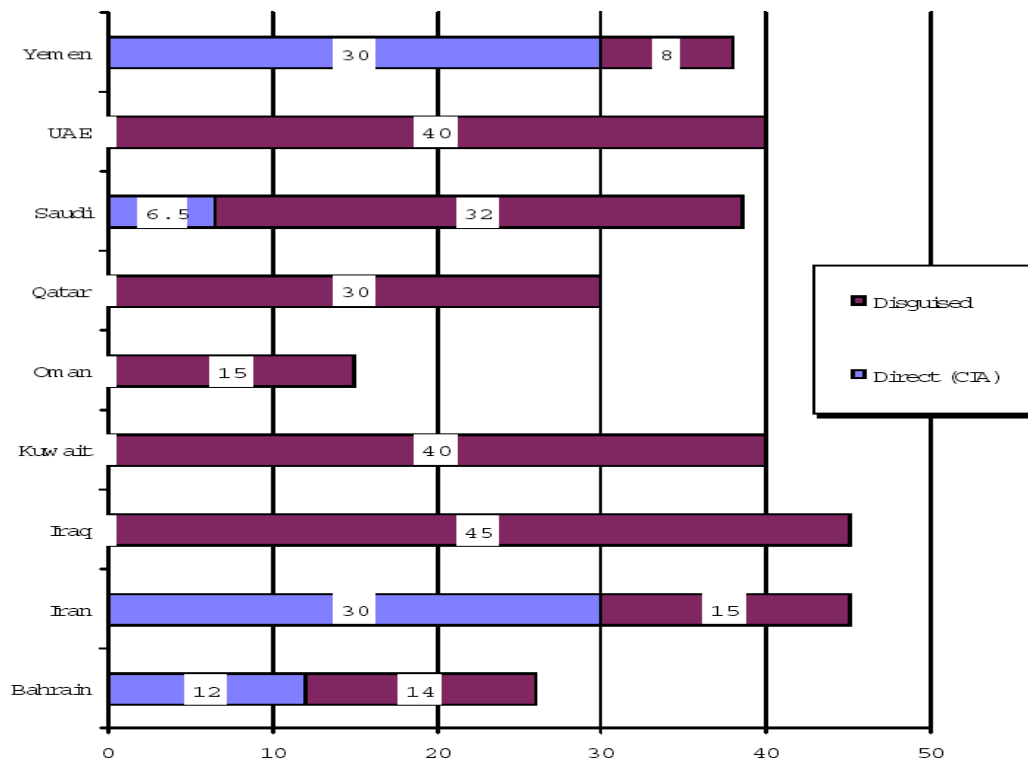


Figure 1. Future Saudi Growth Trends

Over-dependence on Non-Productive Government Jobs Has a Cost: Estimated Comparative  
Direct and Disguised Unemployment Rate in the Middle East: A Rough Estimate

(Rate measured in Percent)

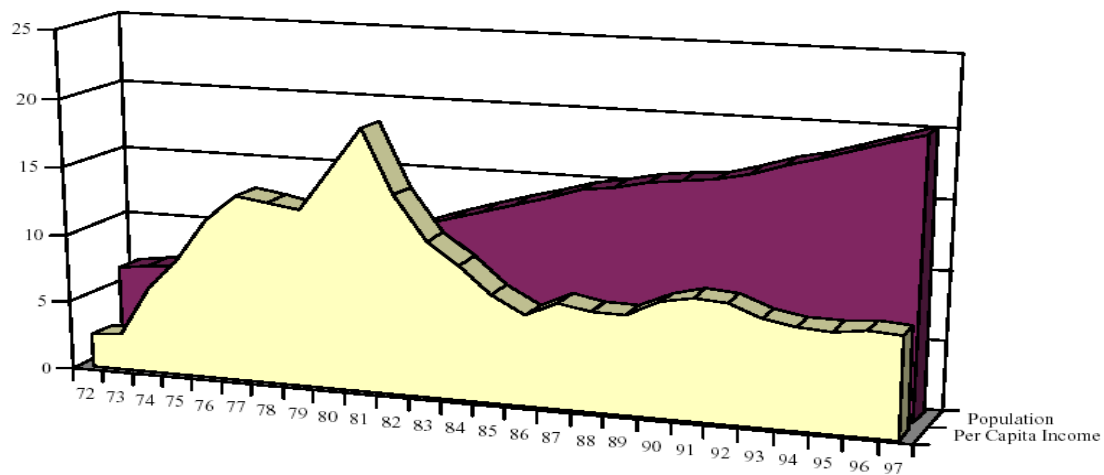


Rough estimate by Anthony H. Cordesman based on CIA and World Bank estimates for 1999. Disguised includes public sector, civil service, and private sector jobs with no use economic output.

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Figure 2. Saudi Employment

**The Demographic Squeeze: Saudi Arabia: Population Growth in Millions versus Per Capita Income in Constant \$US Dollars**  
(Population in Millions; Per Capita Income in Thousands of Constant 1997 \$USD)



	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97
■ Per Capita Income	2.4	2.6	6.3	8.6	12	14	13	13	16	19	15	11	9.8	7.9	6.6	7.7	7.2	7.2	8.3	8.8	8.7	7.8	7.3	7.2	7.4	7.3
■ Population	6.5	6.8	7	7.3	7.7	8.2	8.8	9.5	10	11	11	12	13	13	14	15	15	16	16	16	17	17	18	19	19	20

Adapted by Anthony H. Cordesman from data in various editions of World Military Expenditures and Arms Transfers.

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Figure 3. Saudi Per Capita GDP

**FIGURE 1**

The Relative Regional Population Distribution (PD) and the Urban to Rural (U:R) Ratio in Different Regions of Saudi Arabia.

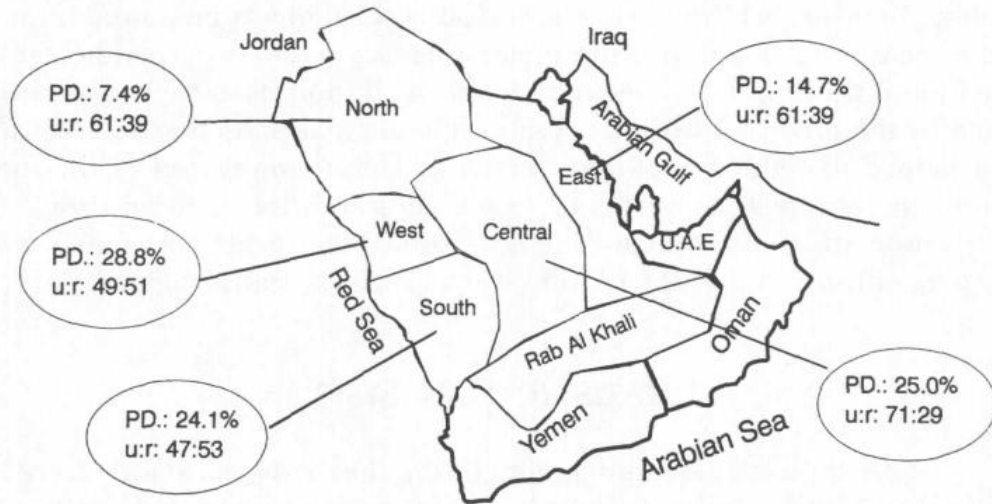


Figure 4. Population Centers



### **III. THE DEPENDENT SAUDI ECONOMY**

#### **A. INTRODUCTION**

Chapter II discussed the significant stresses placed upon the Saudi regime by its countries population growth. Even though this growth is the main cause of immediate stress to the regime, a variable the Royal Family seems unable to control, the economy's inability to provide for these people lies at the heart of the issue. This challenge to Saudi political stability is the inability of its economy to provide jobs and an acceptable standard of living for its people. It is ultimately this failure that could bring rioters, led by conservative opposition groups, to the streets.

The importance of economic development to the Saudi regime lies simply in its ability to provide for the people. Ironically, in order to reform the Saudi economy into an engine that can support this booming population, reforms that will initially increase unemployment and decrease the regimes ability to subsidize living expenses will have to be enforced. Before discussing possible economic reforms we must first take a look at where Saudi money comes from and how the regime is spending it.

#### **B. DEPENDENCE ON OIL**

Saudi Arabia is currently categorized as a 'Resource-Based Growth' economy, that is, one that relies almost exclusively upon its resource base and world market demand to provide for its per capita income. During the early 1800's countries were able to advance their standing in the world market by innovating the transfer methods of their resources. This was accomplished by either moving larger amounts, lesser, yet more precious commodities, or in the case of switching from coal to oil with the development of the steam engine, the discovery of utilizing newfound resources in a more efficient manner.

As market prices leveled the field of play and transportation and communication costs fell, countries rich in resources became followers to countries that could consistently develop, maintain, and most effectively implement new technologies into their economies. Even before the self-induced oil boom of the 1970's Saudi Arabia found itself falling behind countries more heavily invested in research and development. As the

Saudi regime has witnessed, massive infusions of money alone are not enough for an economy to be considered developed.

The desired goal, since the early 1970's, of the royal family has always been to create an economy less dependent on oil and one that could incorporate modern technologies of the more successful countries in the global market. Ironically, this desire to transform is arrested by the one aspect of the economy that could make it possible.

One theory, established by Argentinean economist Prebisch in the 1950s<sup>47</sup>, explains that more advanced countries are merely developing substitutes for previously necessary resources which explain the gap in development between resource rich and poor states. Another, the "Dutch Disease,"<sup>48</sup> promotes the idea that countries with a disproportionably rich resource base make it unprofitable to invest in other sectors of the economy. Other factors discourage internal reform as well. Money is diverted within the government to establish personal control over and direct enrichment from these resources. They actually become a focal point of domestic struggle.

It is clear that the health of the Saudi economy is based almost entirely upon world oil demand with 90% of the country's exports coming from crude and refined oil products. There is little to no smoothing effects from non-oil GDP to the economy in times of oil price fluctuation. These fluctuations have, in the past, been completely due to unforeseen international and regional conflicts as shown at the end of this chapter in Figure 5.

As an example, oil revenues in 1998 dropped by \$18 billion from 1997 estimates. Programs that were cut included defense programs, agriculture, infrastructure investments, Aramco exploration budgets, and delays in payment to private contractors.<sup>49</sup> However, direct subsidies to everyday utility expenses like electricity, water, and telephone services were maintained.

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<sup>47</sup> Sachs, Jeffrey D. "Globalization and Patterns of Economic Development." *Weltwirtschaftliches Archive*, 2000, pp. 583-593.

<sup>48</sup> Ibid

<sup>49</sup> Moore, Phillip. "The kingdom looks beyond oil." *Euromoney*. September 2000, pp. 294-300.

Brad Bourland, the chief economist at Saudi American Bank (Samba) points out the direct link between Saudi GDP growth, its oil sector, and the world oil markets. In 2000 GDP grew by more than 20%, the first year since 1983 in fact that the government didn't run a deficit. Conversely, Saudi GDP decreased almost 11% in 1998 when oil prices bottomed out at almost \$8/bbl in light of the Asian economic crisis, the UN sanctioned increase of oil coming out of Iraq, and unilateral OPEC decision to cut production. Fluctuations of the price of oil aside, since 1992 the GDP of Saudi Arabia has only increased between zero and 2% a year.<sup>50</sup>

### **1. GDP Projections and Requirements**

The above growth figures for the non-oil sector contrast with targeted GDP growth projections for the seventh economic plan (2000-04). These projections call for an average overall 3% GDP growth rate per year with growth of 5% and 6% in the private and non-oil sectors respectively.

Another target is the creation of over 800,000 jobs within this time frame.<sup>51</sup> In addition, it is estimated that an average real GDP growth of 5-6% is required to supply jobs for the upcoming Saudi workforce.<sup>52</sup> Bourland estimates a 20% unemployment rate for 10 to 29 year olds, a figure which translates somewhere between 6-800,000 youth.<sup>53</sup>

Of this number, an increased saudization rate of 2% a year combined with the projected private sector growth is expected to create 328,000 jobs by plans end. The burden of employing the remainder of youth has been placed upon the oil sector and associated investments into its infrastructure.

This requires the creation of 100,000 jobs per year from the beginning of the most recent economic plan that will end in 2004. So far, less than half the targeted job creation within the oil sector has been realized per annum.<sup>54</sup> Much of private sector foreign

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<sup>50</sup> Al-Sayari, Hamad. "Saudi Arabia: Central bank statement." Euromoney London, 2002/2003, p. 176.

<sup>51</sup> Moin Siddiqi, Janet Matthews Information Services, Technical Review Middle East, Jan 2003, p. 18.

<sup>52</sup> Moore, Phillip. "The kingdom looks beyond oil." Euromoney. September 2000, pp. 294-300.

<sup>53</sup> MacFarquhar, Neil. "Saudis Open Gas Fields to Foreigners," New York Times, June 2001, pp. 2-3.

<sup>54</sup> Middle East Review of International Affairs (MERIA) Journal, Vol. 7, Number 3. Sep 2003, p. 5.

investment for the seventh economic plan hinged upon the Saudi Gas Initiative (SGI) that was terminated earlier in 2003. It is estimated that the SGI would have brought in an excess of \$20 billion in initial investment into upstream Saudi petroleum developments with an additional \$50 billion being attracted to downstream petrochemical development, power generation, and desalinization infrastructures.

## **2. Public Spending**

Another point of interest is what the Royal Family does with its money. Anthony H. Cordesman, from a U.S.-Saudi Business Brief adapted in Fig. 6 at the end of the chapter, depicts how the Saudi budget is allocated. Defense and National Security combined with Human Resource Development, Social Development and Domestic Subsidies to account for 79% of Saudi Arabia's 1999 budget. Of this, estimated by Dr. Abd al-Rahman al-Shaqqawi the director of the Saudi Institute of Public Administration, \$28.5 billion, or 65% of the Saudi government's budget, is dedicated to the paying of salaries alone.<sup>55</sup>

Due to the closed nature of Saudi Arabia, examinations of its accounting practices are not allowed, a provision that further delays acceptance from organizations like the WTO and IMF.

Corruption and excessive commissions to middlemen in Saudi Arabia are accepted as normal business practice. Prince Bandar himself once acknowledged in a PBS interview that an estimated \$50 billion of the nearly \$400 billion spent on modernizing Saudi Arabia since 1970 has been funneled off by corruption. His response was "So what? We did not invent corruption."<sup>56</sup> More specific accounts of corruption and conflict within the Royal Family will be covered in the following chapter.

Current Saudi debt currently stands at about \$171 billion, roughly 90% of its 2002 GDP. Most of this, \$160 billion, is owed to its domestic institutions. Before the 1991 Gulf War Saudi Arabia was able to cover its debts with reserves of more than \$150 billion in 1983. Due to the combination of yearly deficits and the almost \$10 billion cost

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<sup>55</sup> Baer, Robert. *Sleeping with the Devil*. New York: Crown Pub, 2003, p. 154.

<sup>56</sup> <http://www.eia.doe.gov/cabs/saudi.html>, accessed February 2003.

of the Gulf war Saudi Arabia has all but spent this reserve. Current accounts are estimated at \$8 billion.<sup>57</sup>

In order to finance the kingdom's debt the regime has dipped into the state pension fund, initially funded with \$60 billion from the 1970's, and independent government companies since 1992. With almost half the population under the age of 20, these bills won't come due for another four decades.<sup>58</sup>

Surplus reserves and domestic borrowing aside, Saudi Arabia is able to continue its payment of debt only through its positive balance of payments which are almost wholly constituted by oil. Ever since Saudi Arabia began publishing official statistics in 1967 it has had a trade surplus. Due to the closed economic nature of the society, this one-way trading surplus is assured for the immediate future.

On the other hand, Saudi Arabia is running a deficit in foreign services in the form of Saudi nationals leaving the country and spending money abroad. This is not countered by the yearly Hajj to Mecca and Medina that draws upwards of two million people every year. Conservative estimates of this deficit are averaging \$12 billion annually. Although Saudi Arabia currently collects more on foreign investment than it disburses, this will inevitably change when the regime opens up the economy to foreign investment in order to obtain much needed investment for the country's restructuring.<sup>59</sup>

***a. The Danger of Domestic Borrowing***

The advantage of borrowing locally lies in the government's ability to control the amount of foreign money in the economy, a situation that destroyed the economies of Southeast Asia in 1998. Kevin Taecker, chief economist for the Saudi American Bank, reported that only \$7 billion of the Saudi government's debt was owed to foreign banks in 1999.<sup>60</sup>

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<sup>57</sup> Liesman, Steve. "Low Oil Prices Take Toll on Saudi Arabia --- Economic Impact Worsened By Population Boom; Intervention Is Denied." Wall Street Journal. Mar, 1999, p. A13.

<sup>58</sup> <http://www.prsonline.com>, accessed January 2003.

<sup>59</sup> Liesman, Steve. "Low Oil Prices Take Toll on Saudi Arabia --- Economic Impact Worsened By Population Boom; Intervention Is Denied." Wall Street Journal. Mar, 1999, p. A13.

<sup>60</sup> <http://www.prsonline.com>, accessed January 2003.

The draw back to this policy is the discouragement of investment that needs to go into domestic markets. It also raises the interest rates for private business that are in need of capital. Available money, primarily from the elite, goes abroad instead. In fact, net transfers out of Saudi Arabia are among the largest in the world. Conservative estimates of investments abroad start at \$600 billion and go as high as \$1 trillion. In addition, the IMF estimates that roughly \$15 billion leaves Saudi Arabia every year representing the disproportionate expatriate workforce.<sup>61</sup>

Another hazard to borrowing singly from domestic institutions is the temptation by future administrations, in this case the Royal Family, to use foreign credit. In 2002, Saudi Arabian Visa credit debt increased by 23% from the previous year to \$19 billion.<sup>62</sup> Due to the lack of borrowing from foreign institutions, not including regional institutions like the rumored \$5 billion loan from Abu Dhabi in 1998, Saudi Arabia has a pristine credit history.<sup>63</sup> With over one quarter of the world's most coveted natural resource there is an abundance of lenders willing to provide credit.

An IMF consultation paper in 2002 stated that with the current weak implementation of economic reforms in Saudi Arabia, the financial deficit over 2003-2007 would average 4.5% of GDP. It's also estimated that the Saudi current account, estimated to be \$10 billion by the end of 2003, will shift to a deficit and account for almost 6% of GDP by 2007. Saudi budget outlays are becoming more and more preoccupied with debt payment. In 2002 \$7 billion, about 5% of the entire budget, was spent on debt servicing.<sup>64</sup>

Although the danger of borrowing from domestic institutions and depressing the growth of a Saudi free market is significant, the perception from individuals on the street who are removed from macro-economic decisions underscore the danger of the Royal Family's economic policies. Ahmed Al-Baghdadi, a political

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<sup>61</sup> Middle East Review of International Affairs (MERIA) Journal, Vol. 7, Number 3. September 2003, p. 6.

<sup>62</sup> Rossant, John. Templeman, John. "If Big Oil Pumps in Cash, Will It Solve Saudi Woes?," Business Week. Nov 1998, Issue: 3602, p. 58.

<sup>63</sup> Siddiqi, Moin. Janet Matthews Information Services, Technical Review Middle East, Jan 2003, p. 18.

<sup>64</sup> Field, Michael. "The Good Times Have Gone." Euromoney. October 2000, Issue 378, pp. 123-126.

science professor from Kuwait points out, “It doesn’t seem to make any difference to my life whether the oil price is \$10 or \$30. We know we as Kuwaitis have a lot of money but there seems to be no relation between the price of oil and the economic situation - which is bad.” In a country which is richer per capita and whose government employs upwards of 95% of the native population, Kuwait is a smaller scale version of its next-door neighbor.<sup>65</sup>

### **C. GOVERNMENT INFLUENCE UPON THE ECONOMY**

Until the mid 1990’s Saudi domestic policy formed in the early 1970’s was carried over in the social agreement to guarantee any Saudi native a job in the civil service if they decided not to go into private business. This, combined with extensive public subsidizations that included every thing from power and water to airline tickets, cultivated a society focused on consumption, and, aside from the oil related industry manned by foreigners, not production.

Even though current public subsidies have fallen in real terms since the 1970’s and even more with the effective rule by Crown Prince Abdallah, the Saudi economy is still reluctant to the development of an independent business sector.

Having discussed the depressed trend of Saudi debt and repayment, how does the government propose, or, is it even possible to, restructure the economy to produce a consistent budgetary surplus and necessary job market that isn’t dependent solely upon oil sales?

#### **1. Privatization**

The decision of whether or not to privatize in order to attract required Foreign Direct Investment (FDI) lies at the heart of Saudi economic reform. It is necessary to attract the massive foreign investments that are required to develop the deteriorating infrastructures in both the oil industry and public sectors.

The problem lies with attracting capital to these fledgling businesses. One of the major impediments to developing a vigorous private sector is the massive outflow of capital that Saudi Arabia is presently experiencing. The majority of Saudi princes aren’t

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<sup>65</sup> Siddiqi, Moin. Janet Matthews Information Services, Technical Review Middle East, Jan 2003, p. 20.

interested in investing in their own economy due to the lack of this private sector; money is also leaving the economy due to the large expatriate work force.

In addition, foreign companies are also wary of investing money directly into Saudi Arabia, of which the regime owns more than half the economy and one third of the stock exchange, without being directly involved and assured of a fair commercial return on their investment. The WTO and IMF require Saudi Arabia to open its private sector to FDI along with an increased transparency of published transactions before admitting Saudi Arabia into their institutions. How can Saudi Arabia reverse this trend of capital outflow?

Expanding the private business sector in combination with an increased FDI into the infrastructure are two minimum requirements necessary for the Saudization of the Saudi economy. By blending three elements, a private sector based on free market principles, an influx of FDI, and a Saudization of the workforce, the Saudi economy can be restructured to relieve stress placed upon the regime by its country's population growth.

However, before this discouragement of flight capital and the employing Saudi natives can occur, the Saudi regime needs to attract initial FDI. Only through the opening of the most coveted of Saudi industries to foreigners, upstream oil development, will this be accomplished. Once this occurs, additional investments will naturally be attracted to the additional required services such as power generation, desalinization, roads, railways, telecommunications, oil exploration, production, and transportation. In addition, the decrease of subsidies required for solvency will substantially decrease pressures upon budgetary outlays.

If it sounds too easy, it is. The problem with opening such industry to foreigners is not only the concession of dominant control by central government, but the assured rise of unemployment over the short-term as companies attempt to become more efficient.

Once the Saudi regime fully engages itself to promote a private sector and begins attracting foreign investment, it will lose much of its current revenue from direct ownership. To maintain revenue flows for government spending, taxation will have to be



instituted. It's only a matter of time before full representation in exchange for this taxation will come to the fore. Due to current political tensions and anti-western sentiment in the region there's little doubt as to what kind of party would come to power, or partial power, if free elections were now held.

Although the Council of Ministers produced an outline of domestic sectors to be opened up to the private sector in 2002, they provided no timetable or plan to approach how this was to occur. The prospect of complete privatization, combined with an influx of FDI, unsettles many within the Royal Family.

A compromise between entirely government owned institutions and the development of an open market is occurring piecemeal. Ibrahim Al-Assaf, the Finance and National Economy Minister of Saudi Arabia, commented in 2003 "There are substantial reasons to believe that the process will continue," and "structural reforms introduced so far have boosted private sector involvement and helped diversify the productive base." He also observed "further efforts are needed." Private economists within the Saudi economy, like Ihsan Bu Hlaika, are also acknowledging that the Saudi government has "become more convinced that the private sector should take the lead."<sup>66</sup> Although the Saudi government is reluctant, the following state owned enterprises are being opened up to private ownership.

Saudi Telecom (STC) will be offering up to 30% of its shares by the end of 2003; 20% to the general Saudi public and the rest to the General Organization for Social Insurance, the previously mentioned pension funds that have been financing Saudi debt since the early 1990's. The mobile and fixed line sectors will become available to private investment by 2004 and 2008 respectively. It is estimated that STC will have to invest \$5 billion by 2005 to meet development targets in order to keep up with other countries in the region. The current Saudi Mobile telecommunication infrastructure is actually less efficient and services less of the Saudi populace than similar Egyptian

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<sup>66</sup> Phillip Moore, Euromoney, The Kingdom Looks Beyond Oil Sep 2000, pp. 294-300

telecommunications do in Egypt. Currently, only one fixed-line telephone per eight citizens in Saudi Arabia is now available.<sup>67</sup>

The Saudi Electric Company (SEC), established in 2000, will make available 15% of its shares. Current Saudi electrical generation will have to triple from its current 23.6 GW in order to provide for its projected population of 40 million by the year 2020. This investment of \$35-40 billion will have to come almost entirely from the private sector. An Electricity Regulatory Authority (ERA) was established in 2001 by the Supreme Economic Council in order to restructure the energy sector into generation, transmission, and distribution systems which will allow private business to build, own, and operate individual units. Over the next twenty years it is estimated that the Arab world in general will require \$250 billion in additional investments for its electrical generation sectors of which Saudi Arabia accounts for 20%. Most of this investment will have to come from outside the region.<sup>68</sup> Saudi Arabian Airlines will remain fully under state ownership until it can be restructured and its largest debts be repaid.

The Saudi Basic Industries Corporation (SABIC) remains 70% government owned and no further divestment is being proposed. SABIC is the world's eleventh largest petrochemical producer and would be one of the greatest attractors of FDI. Although no date has been set, further discussions to privatize the Saudi Arabian Mining Company (Maaden), Saudi Railways, the Postal Authority, and the National Commercial Bank are to eventually occur.

Somewhat more definite is the chance that shares in the Saline Water Conversion Corporation (SWCC) will soon be available. In 2002 the Supreme Economic Council decided to move ahead in their development of independent water and power projects (IWPPs) which hope to attract investment for up to 60% of the more than \$60 billion required for future water demand in Saudi Arabia by 2020. Under this new resolution foreign companies will be allowed to own up to 70% of an IWPP with the remainder

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<sup>67</sup> Ibid, pp. 294-300

<sup>68</sup> <http://meria.idc.ac.il/journal/2003/issue3/jv7n3a2.html>, accessed October 2003.

under control of the Saudi government. Under previous mandates, before May 2000, foreigners could not own more than 49% of a Saudi based company.

*a. Regime Resistance to Reform*

A guarantor of FDI is clearly access to any type of oil exploration, production, transportation, and development. Oddly enough, yet understandable from a non-reformist perspective, it is Aramco that the Royal Family will not budge on. Only supporting services like transportation, medical care, and housing are being looked at as potential openings to privatization within the company.

The two greatest points of contention in this area are the unemployment risks and a transfer of strategic production to foreign influence. In order to hasten the privatization process in the Saudi oil and gas sectors, an eleven member Supreme Petroleum Council (SPC) was set up in January of 2000 to supervise the countries oil related economic strategies. By October of that year it was apparent that the SPC would in fact take over certain powers from Aramco. However, even though technocrats technically head up the ministries of oil and finance in order to reinforce ideals of transparency and legitimacy, princes serve as deputy ministers and the king or the crown prince always make any major decisions.<sup>69</sup> Needless to say, there is extreme conservative opposition to the opening up of Aramco to foreign influence.

The closest the Saudi regime has come to opening up their oil exploration and production industry was with the Saudi Gas Initiative (SGI) that was finally terminated in June 2003. The SGI was to be the first opening of the Saudi upstream hydrocarbon sector to foreigners. Three operations were to include the development of natural gas projects in South Ghawar, the world's single largest onshore oil field, and exploration along the Red Sea and into southeastern Saudi Arabia as well. An initial investment of \$25 billion from companies ExxonMobil, Shell, BP, Phillips, Marathon, Occidental, Total, and Shell were expected to attract billions more through development of desalination plants, power stations, and natural gas treatment plants. Prior to 1984 all

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<sup>69</sup>Quest Economics Database, Middle East Review World of Information, Saudi Arabia: Country Profile, Oct 2, 2002, pp. 5-7.

natural gas in Saudi Arabia was flared. Since OPEC quotas are focused on production, not export, the more oil that can be replaced by natural gas, primarily for electrical generation, the better.

Negotiations for the SGI, begun in June 2001, finally broke down over the extent to which Saudi Arabia would eventually open up its upstream gas reserves and the commercial return the foreign oil companies were willing to accept.

The Saudi nationalization of its oil production has become a double-edged sword. This Saudi isolationist approach, initiated in 1973, towards foreign oil companies is the motivation that drove these companies to develop compensatory fields in South America, the North Sea, Africa, Australia, and East Asia in the first place. Saudi Arabia now finds itself in the position of wanting the investment of these companies back without their accompanying influences of old.

#### **D. DIVERSIFICATION**

Next to building a modern privatized infrastructure, diversification of the Saudi Arabian economy is perhaps the next most effective step towards its transformation. Diversification is necessary for decreasing the affects of an oil based economy, which creates massive swings from deficit to surplus of the Saudi national GDP through its intimate relationship with world markets, on budgetary outlays and long-range planning.

Saudi Arabia is attempting to diversify through the development of its upstream gas exploration and production, banking and financing institutions, mining, and tourism industries. However, the royal family, through previously mentioned privatization attempts, is also trying to develop its non-oil economy and wean it from direct government (oil) subsidies. This non-oil economy consists of everything from electrical power generation and distribution to water desalination, telecommunications, public transportation and even the postal system.

Outside of oil and mineral wealth, in part because of its traditional dependence on it, the kingdom has a decided disadvantage in its ability to diversify to natural resources that other agricultural and maritime countries enjoy. Agriculture, the only other considerable natural resource outside of oil and mining accounts for 50% of all water use

in the kingdom while making up only 7% of the Saudi GDP, 4% of the labor force, and 5% of non-oil exports.<sup>70</sup> The development of the agriculture sector in Saudi Arabia has enabled the country to become self-sufficient in some foodstuffs like wheat, eggs, and dairy products, but at the cost of depleting scarce water sources and diverting inordinate government resources in order to get crops like wheat to grow in a desert environment. Agriculture should continue to play a role in the overall Saudi economy but its future benefit will depend on an improvement of desalination and irrigation infrastructures as well as a government decision to withhold over-subsidization that caused a flooding of the market in the mid 1970's.

Saudi Arabia's natural resources consist mainly of crude oil and its derivatives. Upstream gas development, of which Saudi Arabia has the fourth largest reserves in the world, holds the most promise for successful diversification from crude oil exports. It's also the least likely area to be opened up to the required foreign investment as discussed previously.

While not comparable to its oil based resources, Saudi Arabia also has a great mineral wealth consisting of copper, uranium, and iron ore, as well as some other precious metals. The Saudi Arabian General Investment Authority (SAGIA) for the foreign privatization of Maaden is currently considering new laws. The real value in this venture may well not be overall economic relief for Saudi Arabia, but an opportunity for the royal family to experiment with a non-strategic industry and FDI.

Due to a lack of other natural resources Saudi Arabia would seem to naturally fall into a category of countries, such as Israel, who have turned their own people into a resource through education and the creation of technologically intensive industries like telecommunications, computer processing, and high end research and development.

Even though investment in both an educational system and an industrial infrastructure for which it to staff is deficient, Saudi Arabia is attempting to develop a manufacturing and industrial base through the export of chemical products and basic construction materials.

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<sup>70</sup> Field, Michael. "The Good Times Have Gone." Euromoney, Oct 2000 Issue 378, pp. 123-126.

Leadership within the royal family, Prince Abdallah, as well as well as technocrats in the oil industry, Oil Minister Naimi, and well know local economists like Ihsan Bu Hlaika have acknowledged that privatization and diversification of the Saudi economy are necessary measures; not only for a globally competitive economy but one that could also provide a competitive standard of living for its people. The powers that govern Saudi Arabia are aware of the requirements to foster economic prosperity yet, due to a desire to retain the current class structure and its benefits, they are still unwilling to share a proportionate amount of influence in foreign investment and domestic government representation.

### **1. Possible Effects of Restructuring**

Taxation is the next step to the economic reforms mentioned above which will have the greatest affect on the royal family. There are no direct governmental taxes placed upon Saudi citizens. The only form of taxation exists with the zakat, a religious tax that varies throughout the Middle Eastern region, which accounts for 2.5% of a person's annual increase in holdings in Saudi Arabia.

There are no organized collection or distribution institutions for the zakat; Saudi's can dispense this money to whichever organizations they see fit. This issue is unpopular among Saudi's, but for different reasons. While both commoners and elites reject the idea of a central tax in favor of this zakat, it is the Saudi elites who stand to loose much more personal wealth than the commoner and are responsible for delaying taxation reforms within the kingdom. Ironically, it is the commoner, although seemingly in-line with the regime on this issue, which would stand to benefit most from a more even distribution of wealth.

The royal family claims Islamic tenants, detestation of western methods, and a traditional policy of government provision as reasons for withholding such reforms. However, in reality it boils down to popular politics. Similar to anti-privatization arguments, taxation of the populous would, like unemployment in the short run, prove too destabilizing for the regime.

While Saudi citizens still enjoy a highly subsidized life style recent increases in utility payments, decreases in agricultural subsidies, and a reduction in students and

patients in need of specialized medical care being sent abroad have decreased from the 1970s and 80s. In contrast, foreign companies operating in Saudi Arabia were being taxed as much as 45% as recently as 2000 while their native partners paid none, except for the zakat, at all.

The General Investment Authority (GIA), created in 2000 and chaired by Prince Abdullah bin Faisal bin Turki, introduced an adjustment to these foreign investment laws that decreased this tax to 30%. The origins of this new investment law originated with the Supreme Economic Council (SEC) that was created in 1999 and chaired by Crown Prince Abdullah himself. Crown Prince Abdullah and Foreign Affairs Minister Prince Saud al-Faisal, while realizing the controversy surrounding these ideas, recognized the necessity of this new strategy and are among the few in the Saudi government who support foreign investment.

Opposition within the Royal Family tends to support the key leaders of vital economic sectors like the Oil Minister Ali Ibrahim Naimi who is also the chairman of Saudi ARAMCO. He maintains that Saudi Arabia can reform and diversify on its own.

#### **E. POSITIVE EFFECTS OF BUDDING REFORM**

The above, dependence on oil, internal resistance, and possible repercussions of economic reform does not imply that Saudi Arabia is in a hopeless situation. Jeffrey D. Sachs<sup>71</sup> suggests that an oil-based economy can become competitive in non-resource based sectors. Other successful economies like East Asia, Korea, Japan, and Israel have been able to develop their economies through investment in human capital, an influx of FDI, and an ability to absorb foreign technology. These countries, like Saudi Arabia, also lie next to major sea-lanes and international markets. Saudi Arabia already possesses many of the attributes of these successful economies.

In order for Saudi Arabia to absorb technologies from abroad however, the regime must first establish policies which will encourage labor-intensive export markets, reverse the direct exchange of oil for money, and encourage FDI. There are examples that the Saudi regime is attempting to do just that.

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<sup>71</sup> Sachs, Jeffrey D. "Globalization and Patterns of Economic Development." *Weltwirtschaftliches Archiv*, 2000, pp. 583-593.

SAGIA set up a General Commission for Investment to bypass middlemen, their associated kickbacks, and allow for a one-stop-shopping area for foreign companies. Under the new laws foreign business can now buy and own land, apply for the same soft loans from the Saudi Industrial Development Fund that nationals do, and benefit from the same Saudi legal protections against the liquidation or expropriation of assets without proportional reimbursement.

Before 2000, foreign companies were limited to a 49% share ownership in any joint ventures with Saudi nationals. With the endorsement of the GIA, foreign investors can now own 100% of business in the sectors where they are allowed to participate. While foreign investors are still barred from upstream oil, pipelines, media, insurance, telecommunications, defense and security, these recent steps to accept FDI within the Saudi economy show willingness by some to adopt modern western business practices. Although Saudi Arabia can now boast the most laissez-faire FDI laws in the region, the amount of FDI coming into the country isn't enough to offset other detrimental economic factors.

Since 1975 there has only been about \$5 billion worth of direct foreign investment within Saudi Arabia. These limited areas for foreign investment have been singled out and heavily taxed.<sup>72</sup> With recent reforms in 2000, SAGIA reported in January of 2001 that foreign investment intentions totaled \$1.6 billion.<sup>73</sup> SAGIA has since issued about 1,372 business licenses worth \$121.1 billion.

In general however, direct influxes of investment have been limited to just a few companies and in limited sectors. For example, the Japanese have a \$200 million desalination plant, the U.S. Chevron Phillips operates a \$1 billion petrochemical company, and a Canadian/Spanish Sugar company brings in about \$283 million.

Internal Saudi restrictions on foreign investments aren't the only reasons for the lack of greater FDI. Of the current \$12.1 billion pledges of FDI to Saudi Arabia since the creation of SAGIA, 76% of this was agreed upon before Sept 11, 2001.

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<sup>72</sup><http://www.eia.doe.gov/cabs/saudi.html>, accessed March 2003.

<sup>73</sup> Khalaf, Roula. "Saudi Arabia urged to speed up economic reform." *The Financial Times Limited*. October 23, 2002, p. 6.



Although taxing Saudi nationals is still considered too controversial for the sensitive political environment, the Saudi government plans to begin taxing expatriate workers as early as 2004. Conservatives in the government view this as a necessity in order to compliment its saudization strategy and make the employment of Saudi citizens more attractive to domestic businesses.<sup>74</sup> Reformists view it as another deterrent to foreign investors who would prefer hiring expatriate workers.

In October of 2002 the IMF completed its annual 'Article IV' assessment under its bilateral Articles of Agreement with the Saudi government. This meeting between IMF staff teams and Saudi officials reviewed the latest economic developments, policies, and performance reviews. Data was taken from the following Saudi sources: three-month Saudi Arabian riyal deposits, liquid assets, gross official reserves, and foreign assets.<sup>75</sup>

The IMF had many positive comments on a wide range of Saudi economic issues to include: non-oil growth, structural reform, reductions in government employment and subsidies, reducing trade barriers, and providing an increased transparency of financial transactions.

Non-oil growth in Saudi Arabia fell in 2000 from 3.9 to 2.9% mainly as a result of decreased private investment stemming from worldwide economic troubles. Even so, although domestic borrowing increased in 2001, Saudi external accounts still showed a surplus of about 8% of GDP. This surplus was attributed to the combination of an increase in non-oil exports and decreased imports as well as oil exports. The firming of oil prices in 2002 also brought growth to the non-oil sector of 4% and an increase to private investment of almost 10%.

Structural reforms in Saudi Arabia have been successful in opening up state monopolies, allowing increased FDI, and introduced a common external tariff among GCC countries that reduced import tariffs in 2001 from 12 to 5%. This lowering of trade barriers to the international trade market, perhaps more than anything else, will speed

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<sup>74</sup> IMF Concludes 2002 Article IV Consultation with Saudi Arabia, <http://www.imf.org/external/np/sec/pn/2002/pn02121.htm>, accessed September 2002.

<sup>75</sup> Ibid

Saudi Arabia's induction into the WTO. Saudi Arabia has also indicated that the introduction date for a new GCC trade union will occur in 2003 with an integrated monetary union by 2010.

Although a central tax doesn't yet exist, discussion of an interim sales tax shows initiative on the part of Saudi government to move in this direction. Another initiative is the reduction of government employment and subsidies through the proposed sharing of social security and pension benefits. This is aimed to provide incentives for Saudi's to enter the private sector instead of relying on the civil service for employment.

In addition to Saudi efforts to stabilize world oil markets, IMF directors were also impressed in their efforts to provide a more accurate and wider dissemination of financial accounts. Although Saudi efforts to restructure should be supported, the difficulty is two fold. First, the regime must want to restructure the Saudi economy. This means not only a redirecting of oil revenues into education, but the required parallel development of infrastructure that can incorporate these skills. Power structures and a reluctance of the Royal Family to change the status quo aside, the regime must also make this education and industry attractive to the populace. Sach's main argument is that a strong exchange rate, caused by a strong natural resource base, will not inhibit the development of other sectors as long as the workforce's skill and proficiency remains competitive.

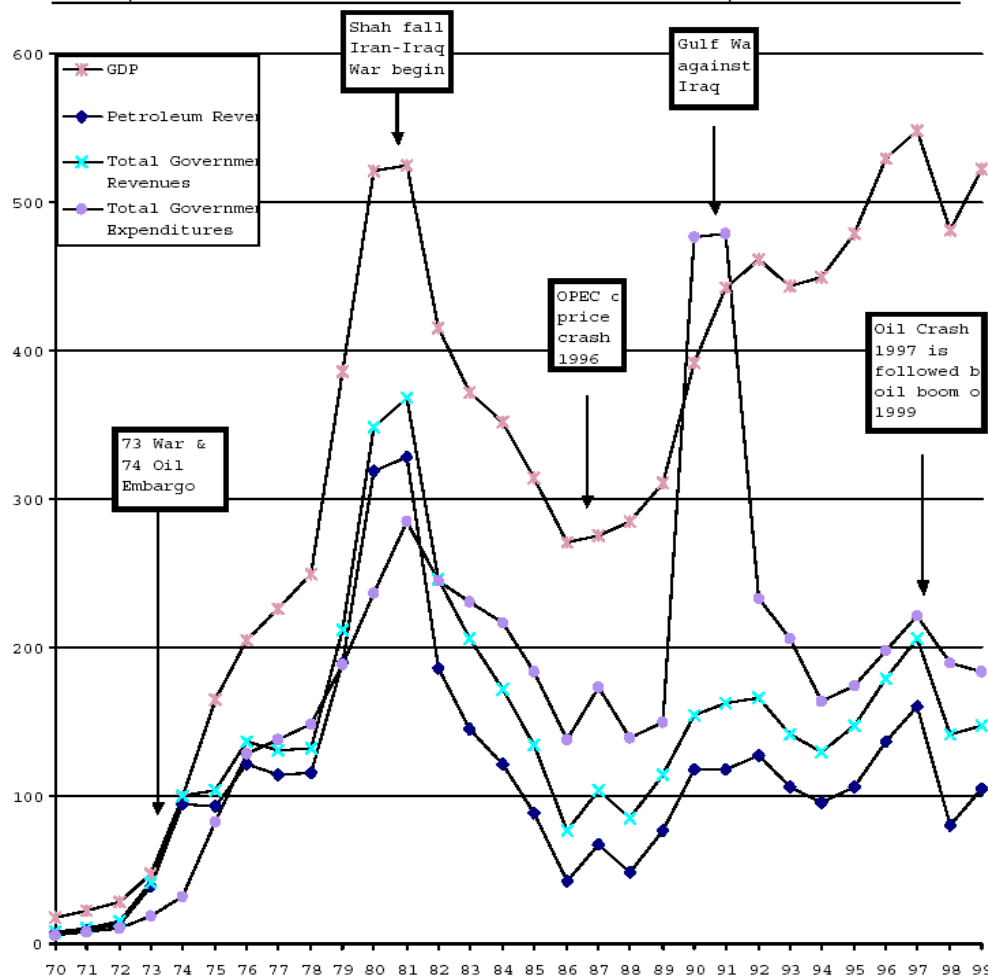
The economy, next to the protection of Islam, is the Saudi regimes central point of legitimacy. It communicates to the Saudi masses on a day-to-day basis the royal family's intentions. Economic reform is by far the single greatest tool the government has to relieve the social and political pressures it now faces from its citizens. Are the reforms now in place sufficient enough to provide a competitive workforce for the ever-increasing youth in Saudi Arabia? Will they be able to quell growing unrest among Saudi citizens?

Unfortunately, a funnel in the form of conservative pressure exists to impede reform. Outside of reformers like Crown Prince Abdullah the princes see the reduction of personal benefits to be unsatisfactory. While reforming the Saudi economy and conforming to the modern global economy can potentially benefit everyone, the distribution of income away from the elites will be quite dramatic. This is an

unacceptable condition of accelerated reform that the majority of the Saudi Royal Family isn't willing to tolerate.

Chapter IV will address the rift in Saudi politics, corruption of the elites, and questions of possible public participation in the Saudi government.

The Impact of Oil Wealth on the Saudi GDP and Government Expenditures: 1970-1999

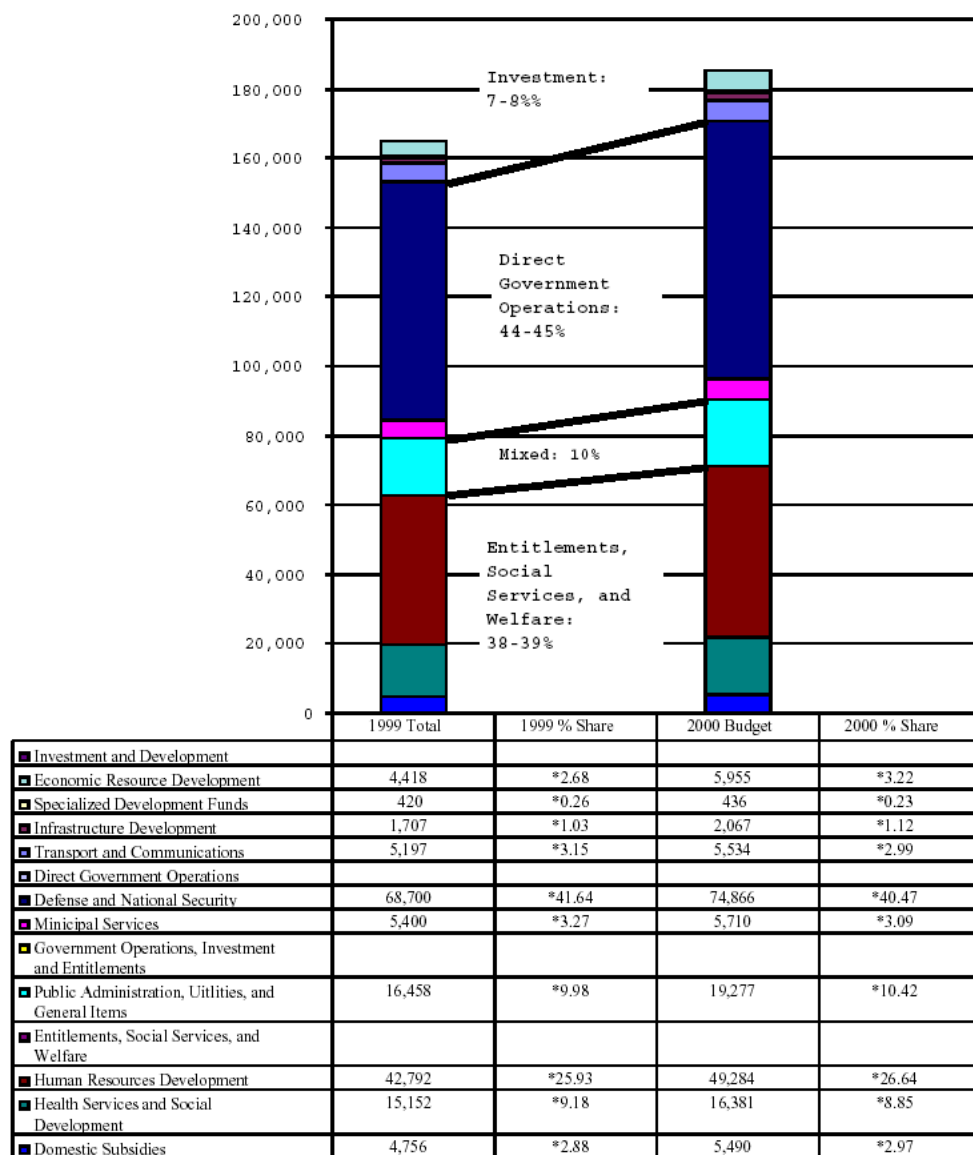


Source: Adapted by Anthony H. Cordesman from Saudi Arabian Monetary Agency, *36<sup>th</sup> Annual Report- 1421H (2000G)*, Riyadh, SAMA, 2001, pp. 343-346, 360-361, 393-395. Note that the Saudi budget cycle was changed in 1990, and the period from 1990-1991 is reported as a single year.

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Figure 5. The Effects of World Oil Markets on Saudi Arabia.

**Pressures on the Saudi Budget: How the Budget is Spent**  
(In billions of Saudi Riyals)



Source: Adapted by Anthony H. Cordesman from US-Saudi Business Brief, winter, 1998, p. 1, and Reuters, December 28, 1998, 1728.

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Figure 6. The Saudi Budget

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## **IV. FOUNDATIONS OF SAUDI RULE**

### **A. INTRODUCTION**

The history of patriarchic rule Saudi Arabia is perhaps even less precise than its economic and population growth data. Although the recounting of the earliest days of Saudi dynasty in the 1700's is many times removed, and any modern information is skewed by the nature of a closed society, the underlying theme of a tribal dominated society is prevalent. This principle of kinship among immediate/extended families, clans, and tribes predates even Islamic influences in the region. The difficulty in creating anything larger than a tribal structure stemmed from the concept of strict kinship. This approach logically promoted ideas like inter-family and arranged marriages, multiple wives, and producing as many children as possible.

### **B. PROVISION: THE FIRST PILLAR**

Even though greatly expanded, the ideals of tribal life were based on that of a single-family unit. In order to preserve tribal strength the flow of power took on a very simple yet respected form that created a pillar upon which to base legitimate rule. Leadership, as well as succession, was based on seniority instead merit. Children tended to follow in their parents footsteps and worries about inter-tribal conflict, procurement of food and water sources, and standards of living were directed to the top of this administration.

The idea that everyone had a specific function and position within the tribe reinforced internal loyalty but created feelings of isolationism and a need to retain the status quo at all costs. This way of life affected the tribal procedure, its interaction with others, and overall progress. There was no concept of loyalty beyond the tribe.

Universal kinship or brotherhood, introduced through Islam in the seventh century, provided the first acceptable means for creating a larger identity among people in the region. However, Islam presented difficulties to tribal leaders as well. Interpretation of the Koran, performed by a select few, was absolute. While man was acknowledged to be fallible, the written word of the Koran was irrefutable.

Acknowledged religious scholars gravitated to positions of authority and the loyalty base within the tribe, though not destroyed, was subtly altered. These alterations lead to a second pillar of ruling legitimacy, one that emphasized obligations to Islamic life over those to tribal leaders. This ideal prevails in Middle Eastern culture even today.

These two pillars, economic provision under a patriarchic rule, and ‘chosen’ leaders guided by Islamic tenets, have guided the Saudi dynasty from its inception in 1710 by Saud ibn Mohammed. By 1714 Saud allied himself with Abd al-Wahhab, a religious leader focused on Islamic fundamentals, in order to add Islamic credence to his position. The origins of the Saudi rentier economy, the use of religion to unite its people, challenges to power, and even early attempts at reform can all be traced back to this early date.

### **1. The Modern Royal Family**

The modern Royal Family of today preserves the distributive economic principles from which the Saudi dynasty was founded. By the early 1700's Saud ibn Mohammed was collecting a 10% zakat from the tribes under his control. This included everything from livestock, valuables, food, and even men at arms.

The formation of the modern Saudi dynasty in 1902 by Abd al-Aziz al Saud (ibn Saud), a direct descendant of its 1710 founder, continued this practice of a family owned and operated kingdom. By 1922 ibn Saud was receiving \$7000/year in British oil concessions in exchange for protecting their oil interests in the Persian Gulf region.<sup>76</sup> This, combined with money from the yearly pilgrimages to Mecca and Medina, recaptured in 1926 from Sharif Hussein, were the only significant resources of the Saudi Kingdom.

Official recognition of the state of Saudi Arabia in 1932 brought with it oil exploration, and a few years later, production. The U.S. recognized the strategic advantages of Saudi Arabia's geographical location and possession of a vital resource. The following money exchanges between the U.S. and Saudi Arabia fostered a stable

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<sup>76</sup> Palmer, Monte. *The Politics of the Middle East*. Illinois: F.E. Peacock Pub. 2002, p. 239.



working relationship, then susceptible to foreign interests, and an almost exclusive exploration and production access to the kingdom.

1953 brought an end to the 10% direct religious tax to tribal leaders. It also, along with the death of ibn Saud, brought in \$253 million from oil revenue's to the kingdom's treasury.

### **C. RELIGION AS A TOOL TO CONSOLIDATE SAUDI AUTHORITY**

This history of regime loyalty based on monetary reimbursement in Saudi Arabia is rivaled only by its loyalty based on religion. Ibn Saud, much like his founding ancestor, was forced to ally himself with the Wahhabi sect in the early 1900's. Upon taking control of Riyadh in 1901 this alliance was necessary to hold onto the central and eastern regions of the Najd and al-Hasa.

Ibn Saud's 1916 consolidation of the Saudi kingdom of old and officially recognized treaty with Britain brought little stability. The creation of two neighboring Hashemite kingdoms, Trans-Jordan, and Iraq, combined not only with the internal politics of fractured tribes, but also with the creation of the Wahhabi based Ikhwan brotherhood in 1912 to destabilize the recently reunited Saudi kingdom.

Ibn Saud and the brotherhood, instead of wasting what little resources they possessed in fighting one another, created a relationship that furthered their own agendas. The Ikhwan, unable to preach to the nomadic Bedouins en masse, backed ibn Saud with their spiritual legitimacy in exchange for swelling their numbers. Ibn Saud dictated that, in addition to his outlays of monetary bribes, conversion to the brotherhood was a new condition of their allegiance to him.

Although the protection and furthering of Islam is a basic tenet of Saudi rule it was rarely used as a practical tool, even in its earliest days, in the running of day-to-day operations of the modern regime. This changed in 1964 when a fatwa was issued by

senior clerics that stated King Saud was unfit to rule. This religious decision, though backed by senior princes and ulema alike, was necessary due to the lack of any formal succession standards.<sup>77</sup>

Ruling legitimacy in exchange for money and state protected religion did not lead Saudi Arabia to peace and prosperity as ibn Saud might have envisioned. In fact, although the Royal Family has struggled for security within and without its borders for most of the twentieth century, internal struggle and foreign aggression began much earlier. The Saudi regime has experienced a full spectrum of internal dissensions to include tribal competition, intense rivalry among the inner circles of the Royal Family; religious rebellions, labor uprisings, and fear of a military coup as well as foreign aggression throughout the years.

#### **D. A HISTORY OF CONFLICT**

Saudi Arabia became the target of its aggressive neighbors as early as 1818. Egypt took over the Hijaz and its cities Mecca and Medina while internal political squabbling led to the fall of the Royal Family to the Shammar tribe in 1891. This also led to their forced flight to Kuwait.

The modern Saudi alliance with the Ikhwan brotherhood in 1916 did strengthen the Royal Families authority, but it also relegated allegiance to The Family as secondary to the Wahhabi strain of Islam. This divergence came to a head in 1929 when ibn Saud, through the use of a separate armed force similar to today's Saudi National Guard, put down an Ikhwan rebellion.

In addition, the traditional rules of succession were brought into question in 1953 when Prince Faisal challenged Prince Saud who clearly lacked experience or interest in filling the shoes of his father. Even though Prince Faisal lacked seniority, it was widely recognized among the princes that he had greater competence for matters of state. That year also brought the first labor uprising when Aramco's workforce walked off the site in protest for better pay and housing benefits.

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<sup>77</sup> Raphaeli, Nimrod. "Saudi Arabia: A Brief Guide to its Politics and Problems," MERIA. September 2000, pp. 5-9.

The regime has the further burden of questioning its military loyalties. As in other countries armed force has been compartmentalized to prevent its use to overthrow the existing government. Not including the relatively insignificant war with Yemen in 1934, and a small Saudi military coup in 1954, the majority of challenges to regime power in the second half of the twentieth century have come primarily from the external aggression of its neighbors. While the Yemeni civil war of 1962-67, backed by both Saudi Arabia and Egypt by proxy, proved to the Saudi regime that it couldn't trust to the loyalty of the military, the Iraqi invasion of Kuwait in 1990 proved that it couldn't rely on its ability either.

Challenged as it was, the Saudi regime under ibn Saud showed early and advanced signs of reform. In 1902 ibn Saud's father resigned his kingship in order to let his son take full control. Ibn Saud also recognized the needs of the more urban and culturally advanced populous in the Hijaz and created a consultative council and constitution for them as early as 1926. He also specifically warned the princes about mixing business and politics.

Two periods stand out in the history of Saudi Arabia's modern regime as times of reform, King Faisal's rule from 1964-75 and the current running of daily state operations by Crown Prince Abdullah. Both faced opposition within the Royal Family, challenges from ideological movements, and intimidating alliances among neighboring states.

Faisal's struggle to reform the Saudi regime began in 1953 with the death of ibn Saud and the placement of his older brother Saud on the throne. King Saud represented many of the criticisms that face the Royal Family today by drawing on the state's treasury for his personal use and spending much of his time attempting to place his more than fifty sons in positions of power. Although Faisal was finally able to take executive powers from Saud in 1957 with the backing from other senior princes, Saud continued his attempt to garner support within and without the regime.

Within the borders of Saudi Arabia Saud tried to align with the Arab Nationalist movement in order to gain popular support while attempting at the same time to consolidate his power within the regime and maintain his position of authority. Outside

the borders Saud attempted alliances with Egypt in the early 1950's against the Hashemite Kingdoms, and then with the U.S. in 1956 and the Eisenhower Doctrine in exchange for military protection and financial backing in the form of trade relations.

Little has changed within the Saudi regime in the past four decades. Crown Prince Abdullah today faces many of the same challenges that King Faisal once did. Prince Abdullah took over the administrative tasks of running Saudi Arabia in 1996 after King Fahd bin Abd al-Aziz suffered a debilitating stroke in the fall of 1995. However, King Fahd is still recognized as the reigning power in Saudi Arabia. Only his death or voluntary turnover of power will allow Abdullah to maneuver freely.

Until that time comes, Abdullah will have to divide his labors between reforming the Saudi economic and political institutions and efforts by key non-reformist princes to undercut his decisions and maintain their power base.

Like King Saud, Fahd also has a reputation of using state funds for his personal use whose individual fortune is estimated at \$20 billion<sup>78</sup>, and shedding Islamic values as soon as he left the country on his many vacations.

### **1. Current Tensions within the Royal Family**

The major distinction between Faisal and Abdullah's challenges within the regime lies in numbers. While Faisal had the backing of many senior princes against Saud, Abdullah has only one, the Minister of Foreign Affairs Saud al-Faisal bin Abd al-Aziz. Together, Abdullah and Saud al-Faisal alone represent senior interests in institutional reform.

Opposition, not including Fahd, consists of six inner-circle brothers of the Sudairi tribe. Abdullah is only half-brother to Fahd and of the Shammar tribe and Saud al-Faisal is a Shaykh.

Crown Prince Abdullah's main opposition within the regime however is Prince Sultan, the Minister of Defense and Air Force (MODA). Sultan stands out in the field of challengers thanks to his seniority, next in line after Abdullah, and his control over the

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<sup>78</sup>Trofimov, Yaroslav. "After King Fahd, a Saudi Feud? Succession Could Take Kingdom Down." Wall Street Journal. September 2002, p. 3.

majority of Saudi military forces. Even though Abdullah heads the National Guard, its loyalties are questionable if an actual coup attempt were to take place.

Like Saud in the 1950's, both Abdullah and Sultan share an affinity for making alliances and then shifting as the situation requires. Abdullah previously enjoyed popular favor among the citizens of Saudi Arabia for his austere lifestyle, ideals of Arab unity, and opposition to U.S. policy in the region while Sultan made much of his fortune from commissions off U.S. arms sales to the kingdom.

Today, although Abdullah has set a personal high standard for spending constraints, Islamic virtues, and attempted reforms within the kingdom, he has grown closer in his relations with the U.S. In attempts to cooperate with the war on terror, finding a solution to the Middle East Peace Process, and complying with U.S. requests to stabilize the world oil market with favorable production levels, Abdullah has lost some standing among the people.

Sultan on the other hand, who has gained much from relations with the west, is now attempting to wrap himself in Islamic trappings to gain a popular standing among the people. Sultan is also attempting to win public support by funding a massive \$1 billion - 2.1 million square foot complex of hospitals and clinics known as "Sultan Humanitarian City" that will provide free services, all from his personal funds<sup>79</sup>.

Ironically, Sultan is one of the main targets of anti-government Islamic fundamentalists who view the Saudi regime as hopelessly corrupt. Sultan has held his position in the ministry of defense for the past 23 years and his own personal fortune was estimated by Fortune magazine at \$4 billion in 1993.<sup>80</sup>

Finally, the comparison of regional and international alliances among Saudi's neighbors hasn't gone unnoticed. In 1958 a brief unification between Egypt and Syria occurred with the formation of the UAR. Iraq also experienced a bloody coup that year which made many monarchies in the region look to their own military loyalties. Although

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<sup>79</sup> Ottaway, David B. "Saudi Court Case Raises Question of Wide Corruption by Leadership." The Washington Post. January 19, 2002, p. 3.

<sup>80</sup> Aburish, Said K. "Saudi Arabia; Coming Change Bodes Ill." The Los Angeles Times. December 2001, p. 2.

never as fully engaged as the U.S. is today in Iraq, the Soviet Union was acknowledged in their support of Egypt at the time. This dual threat of socialist ideology and military backing from a major foreign power affected the Saudi regime much as the concept of a neighboring democratic, U.S. backed Iraq does today.

So while the players have changed, many key issues affecting the stabilization of the Saudi regime have remained the same. As in 1957 with King Saud's attempt to prolong his power base, Arab nationalists wanting to overthrow the government, and Faisal's reform efforts, Abdullah is faced with related challenges in Prince Sultan, Islamic fundamentalists, and his own attempts at reform.

How has Saudi Arabia been able to continue this form of government that has seen no appreciable change in over 100 years? As in many things, through timing, a bit of luck, and some key decisions, the Saudi family was able to maintain its ruling structure much like a rare species surviving in the Galapagos.

Where few states escaped the affects of colonialism in the early 1900's when both the British and French empires were near the height of their strength, Saudi Arabia didn't formally exist. To the British, Saudi Arabia was no more than a collection of tribes that patrolled its interests in the Persian Gulf for a small fee. By the time the Saudi state emerged in the 1930's the major empires were beginning to recede and the kingdom was discovered to possess an extremely valuable resource.

Due to the Saudi's location, possession of resources, and international circumstances, namely WW II and the following Cold War, a U.S. and Saudi relationship seemed inevitable. Once the Saudi regime was firmly in place, it took advantage of the early, some say continuing, one-sided U.S. foreign policy that seemed to exchange reform and long-range stability for short run U.S. interests.

The U.S. presently exchanges corruption, human rights issues, and provides protection services for a stabilized world oil market and a guaranteed market with which to recycle oil for arms sales. In effect this allowed the Saudi's to provide a social contract to its people that trades their political voice for economic security. This, along with a tenuous base in Islam, provides the two pillars of ruling legitimacy for the regime.

Similar to the dynamic effects that injecting Islamic tenets into the ruling structure had on regime alliance, the regime, as subtly, began to slip the idea of a social contract into Saudi society to make people more reliant on the services provided by government.

The first large influx of spending on the people of Saudi Arabia occurred in 1970 and was followed by an even larger spending plan in 1975. In 1992 Fahd also created the Basic Law in response to petitions from senior ulema, which although still acknowledging the Koran as the source of all authority, it in effect retained King Fahd as the sole executor of any major decisions and appointments within the government. This relationship between Saudi Arabia and the U.S. is greatly attributed to the survival of the Saudi regime and its continued antiquated governmental practices.

## **2. Major Threats to Regime Authority**

Discussions on internal-external threats aside, the two major threats to the Saudi regime today are represented by Islamic conservatives and the independent maneuverings for power among the senior princes. History has shown that the Saudi regime possesses the resolve remain in power even when they are at odds with their people on many issues. This, coupled with the lack of any immediately aggressive neighbors and assured protection from the west, leaves the various opposition groups within kingdom as the primary threat to the Royal Family.

Although the Islamic groups condemn the lack of Islamic virtue in the regime, their main criticisms are corruption and relations with the U.S. The lack of Saudi involvement in the recent war in Iraq, combined with the massive withdrawal of U.S. troops from the kingdom and recent U.S. disapproval of Saudi efforts in the war on terror have actually enhanced the regimes popularity among the general citizenry. This leaves regime corruption for opposition groups to spotlight.

Western oriented liberal opposition exists as well. However, the reforms they are demanding, increased rights for women, modern court systems based on a rule of law outside the Koran, an elected parliament, and advanced private sector investment programs seem to be making slow, but positive movement in the right direction and therefore require little if any violent action.

The primary issue of regime corruption publicized by conservative Islamists is well founded. It's estimated that the number of princes in existence today number anywhere from 6-9,000. The furthest of these princes from the direct lineage of King Fahd are estimated to command upwards of \$40,000 per person for their household.<sup>81</sup>

Other figures, like King Fahd's estimated \$2 billion 2001 celebration of 20 years in power, a historical theme park constructed for Fahd's son Abd al-Aziz (Azouzi) that cost in the neighborhood of \$4.6 billion<sup>82</sup>, and shopping sprees by Fahd's family in Marbella, Spain up to \$5 million per day are examples of some of the more outrageous forms of abuse.

Saudi Arabia certainly hasn't cornered the market on state corruption nor did it invent the concept. The issue is, in a country of about 24 million, the majority of the wealth lies in the hands of just over a hundred princes in key positions. Furthermore, this wealth, which is doled out as the princes see fit, is considered a gift to the people, not theirs by right.

The fact that the Royal Family engages in forms of corruption like exorbitant commissions on deals with foreign companies, shell companies set up in the U.S. to evade corruption laws, and seizing public lands to sell back to the government at inflated prices<sup>83</sup> only serve to antagonize these groups.

The infrastructure of princes in the Saudi government has been well constructed. A royal decree by King Fahd in 1992 stated that the King should choose the most capable and honest of King Abdel Aziz's (ibn Saud) direct descendents, of which 24 of the original 44 remain, to become Crown Prince. The ramifications of this decree lie in its opposition to the traditional succession by seniority. Although Crown Prince Abdullah is

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<sup>81</sup> Baer, Robert. *Sleeping with the Devil*. New York: Crown Pub, 2003, p. 25.

<sup>82</sup>Ottaway, David B. "Saudi Court Case Raises Question of Wide Corruption by Leadership." *The Washington Post*. January 19, 2002, pp. 2-3.

<sup>83</sup> Trofimov, Yaroslav. "After King Fahd, a Saudi Feud? Succession Could Take Kingdom Down." *Wall Street Journal*. September 2002. pp. 6-8.



senior to Prince Sultan, 79 and 75 years of age respectively<sup>84</sup>, he is only a half-brother to Fahd. This decree would allow the King to choose anyone of ibn Saud's remaining sons, or grandsons.

This decree, as yet untested, in effect is a double-edged sword. While undesirable princes could be avoided for the sake of the kingdom's stability, a whole generation of princes could be skipped if the existing King thought it was in country's best interest to do so. This opened the door for even more political maneuvering that will further damage the regimes stability.

This maneuvering is the heart of another problem that Abdullah faces in support for his reforms, tribal favoritism. Where King Saud failed in the 1950's, King Fahd of the Sudairi tribe has succeeded by surrounding himself with six of his full brothers in powerful positions within the cabinet and state ministries<sup>85</sup>. Prince Sultan is minister of defense with Abd al-Rahman as his deputy, Na'if is in the interior with Ahmad as his deputy, Salman is the governor of Riyadh, and Turki, although currently a businessman, resigned as Saudi Arabia's head of intelligence just days before the September 11th attacks upon the U.S<sup>86</sup>.

Apart from this particular consolidation of tribal power, princes hold practically all other primary positions in Saudi government as well. Senior analysts from the Middle Media Research Institute (MEMRI)<sup>87</sup> gained this information from studying Saudi daily newspapers and discovered that, all told, about 103 princes are in control.

These positions include the three most powerful state ministries of foreign affairs, defense, and interior as well as their deputies. Even the ministries of finance and petroleum, traditionally held by civilian technocrats, are directly influenced by the princes. The idea behind using non-royals to supervise the Saudi treasury and oil sector is

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<sup>84</sup> Raphaeli, Nimrod. "Saudi Arabia: A Brief Guide to its Politics and Problems." MERIA Journal Vol. 7 September 2003, pp. 7-11.

<sup>85</sup> Baer, Robert. *Sleeping with the Devil*. New York: Crown Pub, 2003, p. xi.

<sup>86</sup> Nimrod Raphaeli, senior analyst for MEMRI and consultant to both World Bank and IMF.

<sup>87</sup> Murphy, Kim. "Saudis Take the Slow Road." The Los Angeles Times. April 2003, p. 4.

to give transparency and accountability to these stations. In addition to placing princes in these ministries as deputies and the fact that neither of these non-royals can defy the senior princes, these positions are primarily reduced to their namesake.

The role of the princes in government also extends to the governors of the thirteen provinces, commanders of all military and guard units, daily newspapers, and most of the influential state-run businesses.

#### **E. POSITIVE EFFECTS OF ABDULLAH'S REFORM EFFORTS**

Even though odds against Abdullah are high, he has been able to make progress in a number of areas such as increasing the power and the possibilities of popular elections among the consultative councils, the introduction of commercial courts for FDI, and limiting commissions on foreign business transactions.

Although King Fahd created the country's first consultative council of 60 members (majlis al-shura) in 1993, it had little affect and was appointed solely by the crown prince. Under Abdullah the number of representatives has increased to 120 and their recommendations have been sincerely taken into consideration. On January 12, 2003 Abdullah decided not to overturn the council's decision to deny the government the ability to tax foreign workers.

Abdullah also took a January 2003 reform petition signed by 104 citizens under consideration by discussing the issues with almost half of the petitioners. The petition called for the instatement of local and national elections, women's rights, and an independent judiciary assembly. Abdullah then put forth his own charter declaring, "that internal reform and enhanced political participation in the Arab states are essential steps for building Arab capabilities."<sup>88</sup>

One of the petitioners who is a lawyer in Jidda, Mohammed Said Tayeb, states, "I deeply believe that reform is the only way to save this country. Because if you leave things as they are, no basic rights, the Saudi family insisting to hold everything, no elections, no popular participation to run the country, it will become very dangerous. I'm afraid the fundamentalists will find a way to take over. Really, we are in the last moment." Conversely, Abdul Mohsen al Atkas, a current member of the council,

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<sup>88</sup>Ibid

declared, “The majlis has frankly less power than it deserves and more power than many people realize. What we need is a controlled, gradual enlargement of the public space. How to do that, reasonable people can disagree.” Regardless of how fast or in what guise reform should come, nearly everyone agrees on the starting place. Ihsan Ali Buhulaiga is an economist on the majlis who supports this view. “Even if you have a democratically elected government in Iraq, I think the impact elsewhere will not be swift and direct. People could say, there you have an American-installed regime. That would be enough to kill it. I would like to change so many things! But I don't want them changed because of you Americans.”<sup>89</sup>

The question then, is the rate of reform. Too much or too fast could destroy not only the Saudi regime, but also the regional and international economic and political relationships around the world. On the other hand, not enough could result in a violent take over of the regime with an even harsher one of extremists.

Either way, the stability of Saudi Arabia depends on Crown Prince Abdullah's ability to walk a straight line towards an increasingly liberalized society. His task is made more difficult by the domestic and international pressures that desire to bend him to their will.

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<sup>89</sup> Murphy, Kim. "Saudis Take the Slow Road." The Los Angeles Times. April 2003, p. 4.

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## **V. CONCLUSION**

### **A. THE SAUDI ELITE/COMMONER RELATIONSHIP**

Population growth in Saudi Arabia today is the single greatest concern of the Royal Family and its future stability. Other inefficiencies within the regime like corruption and closed economic and political policies have only come to the foreground within the last couple of decades as a result of this demographic situation. External threats have lost credence in light of America's commitment to Saudi security, and violent internal threats have so far been contained.

The economy, through employment and living standards, is the regime's most effective tool with which to relieve these growth pressures. The Saudi regime, while recognizing reform as essential to its survival, is nonetheless hesitant in its implementation. This disparity within the Royal Family stems from the rate and extent of proposed reform, too much would be just as threatening as not enough.

Although reform in Saudi Arabia was once easily attained due to the ratio of its population to oil wealth, it is now quite difficult as a result of the relative slight increase in oil revenues compared to the dramatic increase in population. Strangely enough, this growth in Saudi Arabia has the potential to either be its saving grace or its ruin.

The Saudi population in and of itself doesn't constitute a direct physical threat to the regime like the Islamic conservative opposition groups. However, they do provide the idea-logistic support or, shaft of the spear. Before the populous as a whole will rise up against the regime either extreme measures of reform or austerity would have to be placed upon them. Only then would regime opposition be able harness this movement and constitute an actual threat. The Royal Family's ability to remain one step ahead of these groups and denying them popular sympathy lies in its finite advancement towards a liberalized economy and political participation.

## **B. REGIME OPTIONS AND PRIORITIES**

With respect to implementation, the regime has three possible courses of action. They can crack down and enforce a full dictatorship modeled after neighbors like Iraq or Syria and abandon any effort to consult with the people on the pace of reform. Although the regime realizes the need, depending on the discharge of this use of force, reform would either stop completely or worse, regress to even worse conditions.

Another option for the regime is to continue on their present path. While reform in both economic and political institutions are taking place, the danger of being overcome by events in the not too distant future is an ever present danger for the Royal Family.

Finally, an accelerated program of reform could be implemented. The risk of such action, while potentially satisfying people's desire to express themselves and opening up the Saudi economy, could possibly bring to power conservative groups whose intolerant policies would dwarf existing conditions.

Economic reform policies for the Saudi regime, for the time being, should take precedence over political ones. Pound for pound, economic restructuring will take the greatest amount of pressure off the regime by providing employment and a perception to the average Saudi that they can, by their own hand, improve their lot in life. The regime should first provide these options, and then work on moderately incorporating Saudi citizens into the political environment.

The following minimum reforms in the macro and microeconomic areas are necessary to address the most pressing issues facing the Saudi economy. In an overall sense, while a greater opening to international trade markets, increased FDI, and replacing Saudi regime monopolies with increased privatized companies will solve many of Saudi Arabia's economic shortcomings, this is not enough.

At the ground level an investment must be made not only in the education of workers and the creation of jobs for them to fill, but more importantly the incentive to enter the workforce in the first place. These incentives may take the form of personal ownership and investment within one's company and competitive pension benefits with

those employed in civil service. Conversely, a decrease in government subsidies, either directly for utilities or indirectly in the form of civil service employment, will also effectively motivate Saudis to enter the workforce as long as one is made available to them.

Politically speaking, Saudi's seem to be predominantly interested in any kind of government participation at this time. At the highest levels Saudi's would like to see a greater transparency and accountability of financial transactions and a more even distribution of money between the royal elites and commoners. As far as experimenting with true democracy, Saudi Arabia could easily initiate local elections on the province level without excessively disrupting the higher levels of government.

### **C. PRESENT CONDITIONS AND CONCERNS**

While Saudi Arabia isn't currently experiencing an economic crisis, without a significant restructuring of its policies, it will within the next decade. Correspondingly, although Saudi Arabia also isn't experiencing a demographic emergency, the population growth there is exerting severe strains upon its economic abilities and political stability. A failure of either will not only have far-reaching effects upon the global economy, but will create serious regional and international security concerns as well.

History has demonstrated that massive influxes of money alone aren't enough to float the Saudi economy. The Kingdom's population growth has out-paced this antiquated model of distribution. Although current reforms and restructuring presently in motion can solve the majority of Saudi problems, they can do so only at a somewhat accelerated pace. The challenge to the regime is to choose a pace of reform that can accomplish these goals of reorganizing the Saudi economy while at the same time ensuring the regime's survivability.

Time is not on the Royal Family's side. Within the next ten years the Saudi regime will have to contend with first time ever succession issues, the coming of age of the next generation of Saudi youth, and the ever increasing strains of population growth on the Saudi infrastructure.

Ten years will see the death of King Fahd, currently 82<sup>90</sup> years of age in 2003, and both Prince Abdullah and Prince Sultan will be in their mid to late 80's at 89 and 85 years of age respectively.<sup>91</sup> The Saudi population will be an estimated 35M by 2013 and the current 50% of the Saudi population under the age of eighteen will either be looking to enter the workforce or reach childbearing age.<sup>92</sup> Even though the Royal Family recognizes the merit of liberalizing, the internal structure of the family may not allow reform at the pace or in the direction required to stave off these impending troubles.

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<sup>90</sup> MacFarquhar, Neil. "Profligate Princes Stir Succession Questions And Threaten Reform." New York Times. November 2001, pp. 3-5.

<sup>91</sup> World Bank, "Country at a Glance: Saudi Arabia," <http://www.worldbank.org/transport/rail/rdb/raildata/saudi.xls>.

<sup>92</sup> Trofimov, Yaroslav. "After King Fahd, a Saudi Feud? Succession Could Take Kingdom Down." Wall Street Journal. September 2002, p. 3.



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